**IN THE UNITED STATES BANKRUPTCY COURT**
**NORTHERN DISTRICT OF TEXAS**
**FORT WORTH DIVISION**

| | | |
|---|---|---|
| **IN RE** | § | |
| | § | |
| | § | **Case No. 10-47176-11** |
| **REOSTAR ENERGY CORPORATION, ET AL.,**[1] | § | |
| | § | |
| | § | **Chapter 11** |
| | § | **(Jointly Administered)** |
| **Debtors.** | § | |

**SECOND AMENDED DISCLOSURE STATEMENT UNDER 11 U.S.C. § 1125**
**IN SUPPORT OF DEBTORS' SECOND AMENDED JOINT PLAN OF REORGANIZATION**
Dated: October 28, 2011
Fort Worth, Texas

**THIS DISCLOSURE STATEMENT HAS NOT YET BEEN APPROVED BY THE COURT FOR VOTING**

**THE DISCLOSURE STATEMENT HAS BEEN PREPARED BY THE DEBTORS AND THEIR CO-PROPONENT, RUSSCO ENERGY LLC, AND DESCRIBES THE TERMS AND PROVISIONS OF, AND SETS FORTH CERTAIN MATERIAL CONSIDERATIONS IN CONNECTION WITH, THE DEBTORS' SECOND AMENDED JOINT PLAN OF REORGANIZATION (THE "PLAN"). ANY CAPITALIZED TERM USED IN THIS DISCLOSURE STATEMENT THAT IS NOT DEFINED HEREIN HAS THE MEANING ASCRIBED TO THAT TERM IN THE PLAN.**

**THE DEBTORS URGE YOU TO ACCEPT THE PLAN BY SIGNING AND RETURNING THE BALLOTS MAILED TO YOU ALONG WITH THIS DISCLOSURE STATEMENT. IN THE EVENT THAT THE PLAN IS NOT CONFIRMED, THE DEBTORS LIKELY WILL BE FORCED TO LIQUIDATE THEIR ASSETS UNDER CHAPTER 7 OF THE BANKRUPTCY CODE. IN A CHAPTER 7 LIQUIDATION, THE DEBTORS BELIEVE THAT UNSECURED CREDITORS WOULD RECEIVE NO DISTRIBUTIONS OR ELSE SUBSTANTIALLY LESS THAN IS CONTEMPLATED BY THE PLAN.**

**Bruce W. Akerly**
**Texas Bar No. 00953200**
**bakerly@canteyhanger.com**
**Arthur A. Stewart**
**Texas Bar No. 19203500**
**astewart@canteyhanger.com**
**CANTEY HANGER LLP**
**1999 Bryan Street, Suite 3330**
**Dallas, Texas 75201**
**Telephone: (214) 978-4129**
**Facsimile (214) 978-4150**
**COUNSEL FOR DEBTORS-IN-POSSESSION**

**Stephanie D. Curtis**
**Texas Bar No. 05286800**
**scurtis@curtislaw.net**
**Mark A. Castillo**
**Texas Bar No. 24027795**
**mcastillo@curtislaw.net**
**CURTIS | CASTILLO PC**
**901 Main Street, Suite 6515**
**Dallas, Texas 75202**
**Telephone: (214)752.2222**
**Facsimile: (214)752.0709**
**COUNSEL FOR CO-PROPONENT RUSSCO ENERGY LLC**

1 The Debtors are ReoStar Energy Corporation, Case No. 10-47176; ReoStar Gathering, Inc., Case No. 10-47198; ReoStar Leasing, Inc., Case No. 10-47201; and ReoStar Operating, Inc., Case No. 10-47203.

**TABLE OF CONTENTS**

ReoStar Energy Corporation, ReoStar Gathering, Inc., ReoStar Leasing, Inc. and ReoStar Operating, Inc., the Debtors-in-Possession (hereinafter collectively referred to as "Debtors")[2] in the above-captioned Jointly Administered Chapter 11 Case (the "Bankruptcy Case"), together with co-proponent, Russco Energy LLC ("Co-Proponent" or "Russco"), submit the following Second Amended Disclosure Statement in connection with its proposed Second Amended Joint Plan of Reorganization (the "Plan") under Chapter 11 of the Bankruptcy Code.

## NOTICE

The Debtors, together with co-proponent, Russco, have proposed a Second Amended Joint Plan of Reorganization, dated October 28, 2011, as may be amended, (the "Plan") for the benefit of the creditors of the Debtors.

All holders of Claims or Interests are encouraged to read and carefully consider this entire Disclosure Statement, including the Plan, which is attached hereto as Exhibit A. Voting instructions regarding the Plan are provided in this Disclosure Statement, and the Plan. The Plan can only be confirmed if at least one Class of Voting Claims votes in favor of the Plan.

This Second Amended Disclosure Statement for Debtor's Joint Plan of Reorganization (hereinafter "Disclosure Statement") has been prepared by Debtors pursuant to section 1125 of the Bankruptcy Code, which requires that creditors receive a written Disclosure Statement containing sufficient information about the Debtors to enable creditors to make an informed and intelligent decision regarding the Plan. Prior to the solicitation of your vote on the Plan, and as required by the Bankruptcy Code, the Bankruptcy Court will have approved this Disclosure Statement as containing adequate information, as further discussed below.

In addition to this Disclosure Statement and accompanying Plan, you will also receive an order of the Court establishing a hearing date and time on confirmation of the Plan and establishing deadlines for casting your vote or filing objections to confirmation. Mailing instructions are included in your Ballot. YOUR VOTE IS IMPORTANT. In order for the Plan to be accepted, at least two-third (2/3's) in amount and one-half (½) in number of the voting creditors in each class must affirmatively vote for the Plan. Even if all classes of claims accept the Plan, the Bankruptcy Court may refuse to confirm the Plan. Among other things, section 1129 requires that the Plan be in the best interests of the creditors and other parties in interest, and generally requires that the holders of the claims not receive less than would otherwise be realized if the Debtors were liquidated under Chapter 7 of the Bankruptcy Code.

In appropriate circumstances, the Bankruptcy Court may confirm a Plan even though less than all of the classes of claims accept the Plan. The circumstances warranting confirmation notwithstanding the vote of a dissenting class or classes of creditors are set forth in Section 1129(b) of the Bankruptcy Code. Except as otherwise provided in the Plan, the Order of Confirmation, or Section 1141(d), confirmation of the Plan will discharge the Debtors from all of their debts. Confirmation makes the Plan binding on the Debtors and all of their creditors, regardless of whether or not they have accepted the Plan.

The Debtors believe that the Plan is in the best interests of all holders of Claims, provided the Debtors' assumptions and estimations of Claims herein are correct.

## PLAN SUMMARY

---

2 *In re ReoStar Energy Corporation*, Case No. 10-47176 ("ReoStar Energy"), *In re ReoStar Gathering, Inc.*, Case No. 10-7198 ("ReoStar Gathering"), *In re ReoStar Leasing, Inc.*, Case No. 10-7201 ("ReoStar Leasing"), and *In re ReoStar Operating, Inc.*, Case No. 10-7203 ("ReoStar Operating") are Jointly Administered Cases under Case No. 10-47176, and hereby submit their Joint Plan of Reorganization with Co-Proponent Russco Energy LLC.

The Plan, proposed by the Debtors and their Co-Proponent, Russco, provides for the restructure of Debtors and their emergence from bankruptcy as reorganized privately held entities. The Plan further provides for payments to Allowed Administrative, Priority, Secured and Unsecured Creditors upon Confirmation as set forth below. A more detailed discussion of the Plan and its implementation, together with projections of income and expenses and the time necessary to complete the payments under the Plan is found in the Disclosure Statement accompanying the Plan. The Plan should be read in conjunction with the Disclosure Statement. Debtors urge all Creditors and other parties in interest to consult with legal counsel. Creditors and other parties in interest should not rely on any representations not contained in the Plan and/or Disclosure Statement in making a determination on voting to accept/reject the Plan. A detailed discussion concerning the voting rights of Creditors and other parties in interest is contained in this Disclosure Statement.

**PAYMENTS TO CREDITORS UNDER THIS PLAN**

Each holder of an Allowed Priority Tax Claim against the Debtors shall receive in full satisfaction of such holder's Allowed Priority Tax Claim the amount of such holder's Allowed Claim upon the Effective Date, *provided, however*, that each Allowed Priority Tax Claim may receive such other treatment as may be agreed upon in writing by the holder of such Allowed Priority Tax Claim.

After payment of Secured Claims, Administrative Claims, and Priority Claims under the priorities of the Bankruptcy Code, the Debtors have agreed to pay some holders of Allowed General Unsecured Claims their Pro Rata Share of (a) twenty percent (20%) of their Allowed General Unsecured Claim amounts over thirty-six (36) equal monthly payments starting on the first business day following the Effective Date, plus up to (b) fifty percent (50%) of the Net Proceeds, if any, from all Estate Actions pursued by the Debtors, and one hundred percent (100%) of the Net Proceeds, if any, from all Estate Actions pursued by the Creditor Trustee as described in the Disclosure Statement.

Notwithstanding any other provision of the Plan, no General Unsecured Creditor shall be entitled to receive more than one hundred percent (100%) of the Allowed Amount of such respective Creditor's Allowed General Unsecured Claim. The Claims Payment Schedule, set forth in Exhibit B to the Disclosure Statement (the "Plan Projections"), is:

| Class | Est. Claim Amt. | Est. Pay. Amt. | Payment Sched. |
|---|---|---|---|
| Class 2.2 - Allowed secured claim of BT & MK | Unknown (Adversary Pending) | Unknown (Adversary Pending) | Amount of Allowed Secured Claim; paid in full over 10 years amortized at 5% |
| Class 3.1 - Allowed priority unsecured claims of ReoStar Energy | $2,800 | $2,800 | $2,800 at Effective Date |
| Class 3.2 - Allowed priority unsecured claims of ReoStar Operating | $25,400 | $25,400 | $25,400 at Effective Date |
| Class 4.1 - Allowed unsecured claims of ReoStar Energy | $3,500,000 | $700,000 | $19,444 / mo. for 36 mo. beginning on the Effective Date |
| Class 4.2 - Allowed unsecured claims of ReoStar Operating | $41,000 | $8,200 | $228 / mo. for 36 mo. beginning on the Effective Date |
| Class 4.3 - Allowed unsecured claim of BT & MK | Unknown (Adversary Pending) | Unknown (Adversary Pending) | 20 % paid over 36 mo., if Allowed |

If the Plan is confirmed, the Claims of holders of Allowed Claims against the Debtors will be entitled to distributions and treatment as set forth in the Plan. Due to the large amount of Secured, Administrative, and priority Claims against the Debtors, **priority Claims would receive only partial payment and there would be no funds remaining for distribution to holders of General Unsecured Claims if the Plan were not confirmed and the Debtors were forced to liquidate.**

Please consult the Plan, attached as Exhibit A hereto, for further details.

# I. INTRODUCTION

## A. Filing of the Debtors' Chapter 11 Bankruptcy Cases

On November 1, 2010 (the "Petition Date"), the Debtors each filed voluntary petitions for relief under Chapter 11 of the United States Bankruptcy Code (the "Bankruptcy Code") in the United States Bankruptcy Court for the Northern District of Texas, Fort Worth Division before the Honorable D. Michael Lynn, United States Bankruptcy Judge (the "Court"), commencing these Jointly Administered Chapter 11 Cases (the "Bankruptcy Case"). Since that time, they have continued to operate as Debtors in Possession pursuant to the provisions of sections 1107 and 1108 of the Bankruptcy Code.

## B. Purpose of the Disclosure Statement

This Disclosure Statement is submitted by the Debtors pursuant to section 1125 of the Bankruptcy Code in connection with the Debtors' Plan. A copy of the Plan is attached to this Disclosure Statement as Exhibit "A." For purposes hereof, any term used in this Disclosure Statement (regardless of capitalization) and not otherwise separately defined herein shall have the defined meaning ascribed to it in Annex 1 which is the Glossary to the Plan, the Plan or, if not defined in the Glossary or Plan, then in section 101 of the Bankruptcy Code. As used herein, "Reorganized Debtors" means the privately held Debtors, on and after the Effective Date of Confirmation of the Plan.

Pursuant to Section 1125(b) of the Bankruptcy Code, a precondition to solicitation of acceptances and rejections of a Plan of Reorganization from holders of claims or interests in the bankruptcy estate is that the holders be furnished with a copy of the Plan or a summary of the Plan and a written Disclosure Statement which contains "adequate information".

"Adequate information" means information of a kind, and in sufficient detail, as far as is reasonably practicable in light of the nature and history of the Debtors and the condition of the Debtors' books and records, that would enable a hypothetical reasonable investor typical of holders of claims or interests of the relevant class to make an informed judgment about the Plan, but adequate information need not include such information about any other possible or proposed Plan. 11 U.S.C. § 1125(a)(1).

Whether or not a Disclosure Statement contains adequate information is determined by the Court upon notice and hearing. 11 U.S.C. § 1125(b). All parties in interest may participate in this determination. After the Disclosure Statement is approved by the Court, a hearing will be set on confirmation of the Plan and a Plan package which includes copies of the Order Approving Disclosure Statement, Plan, Disclosure Statement and Ballot will be sent to the parties entitled to vote on the Plan.

The Court's approval of this Disclosure Statement does not constitute an endorsement of any of the representations contained in either the Disclosure Statement or the Plan, nor does it constitute an endorsement of the Plan. Approval does indicate, however, that the Court has determined that the Disclosure Statement meets the requirements of section 1125 of the Bankruptcy Code.

**IT IS OF UTMOST IMPORTANCE THAT YOU READ THIS DISCLOSURE STATEMENT IN FULL AND IN CONJUNCTION WITH THE PLAN AND GLOSSARY ATTACHED HERETO.**

**OTHER THAN THIS DISCLOSURE STATEMENT, NO STATEMENT OR INFORMATION GIVEN FOR THE PURPOSE OF SOLICITING ACCEPTANCES OR REJECTIONS OF THE PLAN HAS**

**BEEN APPROVED BY THE BANKRUPTCY COURT CONCERNING (1) THE DEBTORS AND THEIR BUSINESS, ASSETS OR PROPERTY; (2) THE REORGANIZED DEBTORS AND THE PROJECTED RESULTS OF THEIR FUTURE BUSINESS OPERATIONS AND FINANCIAL CONDITION; OR (3) DISTRIBUTIONS TO BE MADE UNDER THE PLAN. YOU SHOULD USE CAUTION IN CONSIDERING ANY STATEMENT OR INFORMATION IN MAKING YOUR VOTING DECISION BASED UPON INFORMATION NOT CONTAINED HEREIN.**

**THIS DISCLOSURE STATEMENT MAY NOT BE RELIED UPON FOR ANY PURPOSE OTHER THAN TO DETERMINE WHETHER TO VOTE TO ACCEPT OR REJECT THE PLAN. THIS DISCLOSURE STATEMENT CONTAINS PROJECTED FINANCIAL INFORMATION REGARDING THE DEBTORS AND THE REORGANIZED DEBTORS AND CERTAIN OTHER FORWARD-LOOKING STATEMENTS, ALL OF WHICH ARE BASED ON VARIOUS ASSUMPTIONS AND ESTIMATES AND WILL NOT BE UPDATED TO REFLECT EVENTS OCCURRING AFTER THE DATE HEREOF. SUCH INFORMATION AND STATEMENTS ARE SUBJECT TO INHERENT UNCERTAINTIES AND TO A WIDE VARIETY OF SIGNIFICANT BUSINESS, ECONOMIC, AND COMPETITIVE RISKS INCLUDING, AMONG OTHERS, THOSE DESCRIBED HEREIN. *SEE* "ARTICLE IX – FEASIBILITY AND RISKS." CONSEQUENTLY, ACTUAL EVENTS, CIRCUMSTANCES, EFFECTS, AND RESULTS MAY VARY SIGNIFICANTLY FROM THOSE INCLUDED IN OR CONTEMPLATED BY SUCH PROJECTED FINANCIAL INFORMATION AND SUCH OTHER FORWARD-LOOKING STATEMENTS.**

The Debtors have an Internet website (www.reostarenergy.com) but it may not contain all information set forth and/or referenced herein, or contained in the Debtors' Chapter 11 Bankruptcy Case or SEC-EDGAR filings, as it would be impractical for the Debtors' website to be managed so as to capture all such information, nor is that the primary purpose of the Debtors' website, which is largely a marketing tool. In voting on the Debtors' Plan, Creditors should not solely rely on information contained on the Debtors' internet website, as such information is not intended to be complete for voting purposes.

C. Hearing on Confirmation of the Plan

Confirmation of a Plan is simply approval by the Court. This approval is sought by the Plan proponent at the hearing on confirmation. In order to obtain approval of the Court, the Plan proponent must show that the Plan meets all requirements for confirmation.

The requirements for confirmation are listed in 11 U.S.C. §1129(a). These requirements are part of the balancing of rights and obligations between the Debtors and their creditors. Certain of the requirements for confirmation necessitate the solicitation of ballots from the holders of claims against and interests in the Debtors indicating either their acceptance or rejection of the Plan. Section 1129(a) does not require that each and every holder of a claim against or interest in the Debtors vote to accept the Plan in order for it to be confirmed by the Court.

First, only those holding claims or interests which are in classes which are impaired are entitled to vote. Impairment is defined in 11 U.S.C. §1124. Impairment basically means an alteration of the legal, equitable or contractual rights of the holder of the claim or interest. The Plan Proponents must assert in the Disclosure Statement whether or not each class is deemed by them to be impaired. The Plan Proponents' conclusion may be disputed by a creditor and the dispute resolved by the Court. If a Plan impairs or changes the rights of any creditor, it must be accepted by at least one Class of impaired claims. Second, only those ballots that are properly completed and timely delivered are counted. Third, of those voting in each class, only a majority of the claims in number and at least two-thirds (2/3) in amount are needed for the acceptance of the Plan by that class.

Even if all Classes of claims and interests accept the Plan, its confirmation may be denied by the Bankruptcy Court for the failure to meet some other requirements of Section 1129 of the Bankruptcy Code. Among those requirements is one that the Plan is in the best interest of claimholders and interest holders. That generally requires that the value to be distributed to claimholders and interest holders may not be less than such parties would receive if the Debtors were liquidated under Chapter 7 of the Code.

D. Sources of Information

**THE STATEMENTS AND THE FINANCIAL INFORMATION ABOUT THE DEBTORS AND/OR THE REORGANIZED DEBTORS, INCLUDING ALL FINANCIAL PROJECTIONS AND INFORMATION REGARDING CLAIMS AND INTERESTS CONTAINED HEREIN, HAVE BEEN PREPARED FROM THE DEBTORS' BOOKS AND RECORDS AND OTHER DATA OBTAINED FROM DISCLOSURES MADE IN DEBTORS' BANKRUPTCY CASES. CERTAIN STATEMENTS REGARDING THE ESTIMATED VALUES OF WORKING INTERESTS AND M&M LIENS THEREON HAVE BEEN TAKEN, IN PART, FROM THE BOOKS, RECORDS, AND INFORMATION OF DEBTORS' AS DESCRIBED IN THEIR BANKRUPTCY CASES. WHILE THE DEBTORS BELIEVE THE INFORMATION TO BE ACCURATE AND COMPLETE, THE DEBTORS AND THEIR PROFESSIONALS HAVE NOT TAKEN ANY INDEPENDENT ACTION TO VERIFY THE ACCURACY OR COMPLETENESS OF SUCH STATEMENTS AND INFORMATION AND EXPRESSLY DISCLAIM ANY REPRESENTATION CONCERNING THE ACCURACY OR COMPLETENESS THEREOF.**

**THE STATEMENTS CONTAINED IN THIS DISCLOSURE STATEMENT ARE MADE AS OF THE DATE HEREOF UNLESS ANOTHER TIME IS SPECIFIED, AND DELIVERY OF THIS DISCLOSURE STATEMENT SHALL NOT, UNDER ANY CIRCUMSTANCES, CREATE AN IMPLICATION THAT THERE HAS BEEN NO CHANGE IN THE INFORMATION SET FORTH HEREIN SINCE THE DATE OF THE DISCLOSURE STATEMENT OR SINCE THE MATERIALS RELIED UPON IN THE PREPARATION OF THE DISCLOSURE STATEMENT WERE COMPILED.**

Certain of the materials contained in this Disclosure Statement are taken directly from other readily accessible documents or are summaries of other documents. While the Debtors have made every effort to retain the meaning of such other documents or portions that have been summarized, the Debtors urge that any reliance on the contents of such other documents should depend on a thorough review of the documents themselves. In the event of a discrepancy between this Disclosure Statement and the actual terms of a document, the actual terms of such document shall apply.

No statements concerning the Debtors, the value of their property, or the value of any benefit offered to the holder of a Claim or Interest in connection with the Plan should be relied upon other than as set forth in this Disclosure Statement. In arriving at your decision, you should not rely on any representation or inducement made to secure your acceptance or rejection that is contrary to information contained in this Disclosure Statement, and any such additional representations or inducements should be reported to counsel for the Debtors:

**Bruce W. Akerly**
**Texas Bar No. 00953200**
**bakerly@canteyhanger.com**
**Arthur A. Stewart**
**Texas Bar No. 19203500**
**astewart@canteyhanger.com**
**CANTEY HANGER LLP**
**1999 Bryan Street, Suite 3330**
**Dallas, Texas 75201**
**Telephone: (214) 978-4129**
**Facsimile (214) 978-4150**
**COUNSEL FOR**
**DEBTORS-IN-POSSESSION**

## II. OVERVIEW OF CHAPTER 11

### A. Overview of Chapter 11

Chapter 11 is a portion of the Bankruptcy Code which provides a business with protection from its creditors while it seeks to reorganize its business affairs, including the repayment of its debts. The terms of the proposed reorganization are embodied in a Plan of Reorganization. While the Bankruptcy Code gives the Debtors many aids in the reorganization of their financial affairs, these aids are balanced with rights and protections afforded to creditors. Confirmation of a Plan of Reorganization is the objective of the Debtors in a Chapter 11 Reorganization Case. Performance of the confirmed Plan is the objective of the Reorganized Debtors. The Plan is the legal document by which the claims against and interests of the Debtors are satisfied.

Chapter 11 is the principal reorganization Chapter of the Bankruptcy Code. Upon the commencement of a Chapter 11 case, section 362 of the Bankruptcy Code provides for an automatic stay of all attempts to collect upon claims against a debtor that arose prior to the bankruptcy filing. Generally speaking, the automatic stay prohibits interference with a debtor's property or business.

### B. Plan of Reorganization

A plan of reorganization sets forth the means for satisfying all claims against, and interests in, the Debtors. Generally, a claim against the Debtors arises from a normal Debtor/creditor transaction such as a promissory note or a trade-credit relationship, but may also arise from other contractual arrangements or from alleged torts. An interest in the Debtors is held by a party that owns all or part of the Debtors, such as a shareholder or partner.

After a plan of reorganization has been filed with a bankruptcy court, it must be accepted by holders of impaired claims against, or interests in, the Debtors. The Bankruptcy Code provides that claim holders and interest holders are to be grouped into "classes" under a plan and that they are to vote to accept or reject a plan by class. While courts have disagreed on the proper method to be used in classifying claim holders and interest holders, a general rule of thumb is that claim holders with similar legal rights are placed together in the same class and that interest holders with similar legal rights are placed together in the same class. For example, all claim holders entitled to priority under the Bankruptcy Code might be placed in one class, while all claim holders holding subordinated unsecured claims might be placed in a separate class. Generally, each secured creditor will be placed in a class by itself because each such creditor usually has a Lien on distinct property and therefore has distinct legal rights.

Independent of the acceptance of the Plan as described above, to confirm the Plan the Court must determine that the requirements of section 1129(a) of the Bankruptcy Code have been satisfied. See below, "Voting Procedures and Requirements for Confirmation," Article III, for a discussion of the section 1129(a) requirements for confirmation of a plan of reorganization.

**THE DEBTORS BELIEVE THAT THE PLAN SATISFIES EACH OF THE CONFIRMATION REQUIREMENTS OF SECTION 1129(a) AND, IF NECESSARY, SECTION 1129(b) OF THE BANKRUPTCY CODE.**

Confirmation of the Plan makes the Plan binding upon the Debtors, the Reorganized Debtors, Claim holders, Interest holders, and other parties in interest irrespective of whether they have filed proofs of Claim or voted to accept the Plan.

## III. VOTING PROCEDURES AND REQUIREMENTS FOR CONFIRMATION

If you are the holder of a Claim or Interest in one of the Classes whose rights are affected by the Plan, it is important that you vote. If you fail to vote, your rights may be jeopardized.

A. Persons Entitled to Vote

Pursuant to the provisions of section 1126 of the Bankruptcy Code, only holders of Claims or Interests that are (i) Allowed, (ii) impaired, and (iii) receiving or retaining property on account of such Claims pursuant to the Plan, are entitled to vote either for or against the Plan ("Voting Claims"). Accordingly, in this Bankruptcy Case, any holder of a Claim or Interest classified in Classes 1, 2.1-2.2, 3.1-3.2, 4.1-4.3 or 6 of the Plan may have a Voting Claim and should have received a Ballot for voting (with return envelope) along with this Disclosure Statement, Plan, and other materials because these are the only Classes consisting of impaired Claims that are receiving property. Under the Bankruptcy Code, any Classes under the Plan that are unimpaired are presumed to vote to accept the Plan and, therefore, votes from such Classes are not solicited. Classes such as Classes 5 and 7 under the Plan that do not receive or retain any property under the Plan as payment of the Claims or Interests within those Classes are presumed to vote to reject the Plan and, therefore, votes from such Classes are not solicited.

As referenced in the preceding paragraph, a Claim must be Allowed to be a Voting Claim. The Debtors filed the Schedules in their Bankruptcy Case listing Claims against the Debtors. To the extent a creditor's Claim was listed in the Debtors' Schedules, and was not listed as disputed, contingent, or unliquidated, or otherwise objected to by the Debtors, such Claim is deemed "Allowed" only in the amount scheduled. Any creditor whose Claim was not scheduled, or was listed as disputed, contingent, or unliquidated, must have timely filed a proof of Claim in the appropriate Debtor's case in order to have an Allowed Claim against such Debtor.

The last day for holders of Claims to have filed their Claims for amounts owed or Interests held prepetition against the Debtors, was March 10, 2011 for non-governmental claims, and April 30, 2011 for governmental claims. After amending the Schedules to reflect that the Claims of alleged creditors Mark Zouvas and Tritaurian Capital, Inc. were disputed, on May 27, 2011, the Debtors filed a Motion to Set New Bar Date for Disputed Claims **[Docket No. 193]**. By Order entered on June 6, 2011 **[Docket No. 201]**, the Bankruptcy Court set July 15, 2011 as the new bar date for the alleged creditors Mark Zouvas and Tritaurian Capital, Inc. to file their Claims for amounts owed or Interests held prepetition against the Debtors. Collectively, these dates constitute the "Claims Bar Dates" for the respective Claims against the Debtors. Claims not filed by the applicable Claims Bar Date are forever barred and discharged.

Absent an objection to a timely filed proof of Claim by the Objection Deadline, such Claim is deemed Allowed. In the event that any proof of Claim is a Contested Claim during the Plan voting period, then, by definition, it is not Allowed for purposes of section 1126 of the Bankruptcy Code, and is not to be considered a Voting Claim entitled to cast a Ballot. Nevertheless, pursuant to Bankruptcy Rule 3018(a), the holder of a Contested Claim may petition the Bankruptcy Court, after notice and hearing, to allow the Claim temporarily for voting purposes in an amount that the Bankruptcy Court deems proper. Allowance of a Claim for voting purposes, and disallowance for voting purposes, does not necessarily mean that all or a portion of the Claim will be Allowed or Disallowed for distribution purposes.

BY ENCLOSING A BALLOT, THE DEBTORS ARE NOT REPRESENTING THAT YOU ARE ENTITLED TO VOTE ON THE PLAN. BY INCLUDING A CLAIM AMOUNT ON THE BALLOT (IF APPLICABLE), THE DEBTORS ARE NEITHER ACKNOWLEDGING THAT YOU HAVE AN ALLOWED CLAIM IN THAT AMOUNT NOR WAIVING ANY RIGHTS THE DEBTORS MAY HAVE TO OBJECT TO YOUR VOTE OR CLAIM.

If you believe you are a holder of a Claim in an impaired Class under the Plan and entitled to vote to accept or reject the Plan, but did not receive a Ballot with these materials, please contact Bruce Akerly, Cantey Hanger, LLC,1999 Bryan Street, Suite 3330, Dallas, Texas 75201,Telephone: (214) 978-4129, Facsimile (214) 978-4150, E-mail: bakerly@canteyhanger.com.

B. Voting Instructions

If you are a holder of a Voting Claim, your vote on the Plan is important. Please read the voting instructions carefully and return your Ballots as specified below and on the Voting Instructions contained in and attached to your Ballots.

*1. Deadline for Submission of Ballots*

BALLOTS MUST BE ACTUALLY RECEIVED BY THE DEBTORS' COUNSEL, WHETHER BY MAIL, COURIER, OR FACSIMILE, ON OR BEFORE _____________at **5:00 P.M. CENTRAL TIME**. ANY BALLOTS RECEIVED AFTER THAT TIME WILL NOT BE COUNTED. ANY BALLOT THAT IS NOT EXECUTED BY A PERSON AUTHORIZED TO SIGN SUCH BALLOT WILL NOT BE COUNTED.

IF YOU HAVE ANY QUESTIONS REGARDING THE PROCEDURES FOR VOTING ON THE PLAN OR YOU DID NOT RECEIVE OR NEED A REPLACEMENT BALLOT, CONTACT BRUCE AKERLY, CANTEY HANGER, LLC 1999 BRYAN STREET, SUITE 3330, DALLAS, TEXAS 75201,TELEPHONE: (214) 978-4129, FACSIMILE (214) 978-4150, E-MAIL: bakerly@canteyhanger.com. THE DEBTORS URGE ALL HOLDERS OF VOTING CLAIMS TO VOTE IN FAVOR OF THE PLAN.

*2. Incomplete or Irregular Ballots*

Ballots that fail to designate the Class to which they apply will be counted, subject only to contrary determinations by the Court, in the Class determined by the Debtors. The Debtors' counsel will use its best judgment in the determination of votes; however, Ballots that do not reflect acceptance or rejection, or reflect both acceptance and rejection of the Plan for a single Claim may not be counted.

*3. Ballot Retention*

Original ballots will be retained by the Debtors' counsel for six months following the Confirmation Date, after which they may be destroyed at the discretion of the Debtors' counsel.

C. Confirmation of Plan

*1. Solicitation of Acceptances*

The Debtors are soliciting your vote. The cost of any solicitation by the Debtors will be borne by the Debtors. No other additional compensation shall be received by any party for any solicitation other than as disclosed to the Bankruptcy Court.

NO REPRESENTATIONS OR ASSURANCES, IF ANY, CONCERNING THE DEBTORS OR THE PLAN ARE AUTHORIZED BY THE DEBTORS OTHER THAN AS SET FORTH IN THIS DISCLOSURE STATEMENT. ANY REPRESENTATIONS OR INDUCEMENTS MADE BY ANY PERSON TO SECURE YOUR VOTE THAT ARE OTHER THAN HEREIN CONTAINED SHOULD NOT BE RELIED UPON BY YOU IN ARRIVING AT YOUR DECISION, AND SUCH ADDITIONAL REPRESENTATIONS OR INDUCEMENTS SHOULD BE REPORTED TO COUNSEL FOR THE DEBTORS FOR SUCH ACTION AS MAY BE DEEMED APPROPRIATE.

**THIS IS A SOLICITATION BY THE DEBTORS AND THEIR CO-PROPONENT, RUSSCO ENERGY LLC, AND IS NOT A SOLICITATION BY ANY SHAREHOLDER, ATTORNEY, FINANCIAL ADVISOR, OR ACCOUNTANT FOR THE DEBTORS. THE REPRESENTATIONS, IF ANY, MADE HEREIN ARE THOSE OF THE DEBTORS AND THEIR CO-PROPONENT AND NOT OF SUCH SHAREHOLDERS, ATTORNEYS, FINANCIAL ADVISORS, OR ACCOUNTANTS, EXCEPT AS MAY BE OTHERWISE SPECIFICALLY AND EXPRESSLY INDICATED.**

Under the Bankruptcy Code, a vote for acceptance or rejection of the Plan may not be solicited unless the

Claim holder has received a copy of a disclosure statement approved by the Bankruptcy Court prior to, or concurrently with, such solicitation. This solicitation of votes on the Plan is governed by section 1125(b) of the Bankruptcy Code. Violation of section 1125(b) of the Bankruptcy Code may result in sanctions by the Bankruptcy Court, including disallowances of any improperly solicited vote.

*2. Requirements for Confirmation of the Plan*

At the Confirmation Hearing, the Court will determine whether the requirements of section 1129(a) of the Bankruptcy Code have been satisfied. If those requirements have been satisfied, the Court will enter the Confirmation Order. The requirements for confirmation under the Bankruptcy Code are as follows:

- The Plan complies with the applicable provisions of the Bankruptcy Code.
- The proponent of the Plan has complied with the applicable provisions of the Bankruptcy Code.
- The Plan has been proposed in good faith and not by any means forbidden by law.
- Any payment made or promised by the proponent of the Plan or by a person issuing securities or acquiring property under the Plan, for services or for costs and expenses in, or in connection with, the case, or in connection with the Plan and incident to the Bankruptcy Case, was disclosed to the Court, and any such payment made before confirmation of the Plan is reasonable, or if such payment is to be fixed after confirmation of the Plan, such payment is subject to the approval of the Court as reasonable.
- The proponent of the Plan has disclosed the identity and affiliation of any individual proposed to serve, after confirmation of the Plan, as director, officer or voting trustee of the Debtors, any affiliate of the Debtors participating in a plan with the Debtors, or a successor to the Debtors under the Plan, and the appointment to, or the continuance in, such office of such individual, is consistent with the interests of holders of Claims and Interests and with public policy.
- The proponent of the Plan has disclosed the identity of any Insider that will be employed or retained by the Reorganized Debtors and the nature of the compensation for such Insider.
- Any governmental regulatory commission with jurisdiction, after confirmation of the Plan, over the rates of the Debtors has approved any rate change provided for in the Plan, or such rate change is expressly conditioned on such approval.
- With respect to each Class of impaired Claims, either each holder of a Claim in such Class has accepted the Plan, or will receive or retain under the Plan on account of such Claim property of a value, as of the Effective Date of the Plan, that is not less than the amount such Claim holder would receive or retain if the Debtors were liquidated on such date under Chapter 7 of the Bankruptcy Code.
- Subject to the Plan proponent's "cramdown" right described in Article III.C.4., which follows, each Class of Claims or Interests has either accepted the Plan or is not impaired under the Plan.
- Except to the extent that the holder of a particular Claim has agreed to a different treatment of such Claim, the Plan provides that Administrative Claims will be paid in Cash in full on the Effective Date and that any tax Claim entitled to priority under section 507(a)(8), the holder of such Claim will receive on account of such Claim regular installment payments, (i) of a total value, as of the Effective Date of the Plan, equal to the Allowed amount of such Claim; (ii) over a period ending not later than 5 years after the date of the order for relief; and (iii) in a manner not less favorable than the most favored nonpriority unsecured Claim provided for by the Plan.
- At least one impaired Class of Claims has accepted the Plan, determined without including any acceptance of the Plan by any Insider holding a Claim in such Class.
- Confirmation of the Plan is not likely to be followed by the liquidation of the Debtors or the need for further financial reorganization of the Debtors or any successors to the Debtors under the Plan, unless such liquidation or reorganization is proposed in the Plan.
- All fees payable under 28 U.S.C. § 1930 have been paid (or the Plan has provided for payment of such fees) on the Effective Date of the Plan.
- The Plan provides for continuation after its Effective Date of retiree benefits, if any, for the duration of the period the Debtors have obligated themselves to provide such benefits.
- All transfers of property of the Plan shall be made according to applicable non-bankruptcy law governing property transfers by a corporation that is not a moneyed, business, or commercial corporation.

The Debtors believe that the confirmation requirements applicable to the Bankruptcy Case are met under the Plan. The Debtors will present evidence in support of each applicable requirement at the Confirmation Hearing.

*3. Acceptances Necessary to Confirm the Plan*

The Bankruptcy Code does not require that each holder of a Claim or Interest vote in favor of the Plan for the Court to confirm the Plan. Rather, the Plan must be accepted by each *Class* of holders of Claims or Interests (subject to an exception discussed below and in Article III.C.4.). Under the Bankruptcy Code, a Class of holders of Claims or Interests has accepted the Plan if, of the Claims in the Class that actually are voted on the Plan, such Claims constituting at least two-thirds in dollar amount and more than one-half in number of voted Allowed Claims vote to accept the Plan, excluding the votes of Insiders. For example, if a hypothetical class has ten claims that are voted and the total dollar amount of those ten claims is $1,000,000, then for such class to have accepted the plan, six or more of those claims must be voted to accept the plan (a simple majority), and the claims voted to accept the plan must total at least $666,667 (a two-thirds majority).

*4. Cramdown*

If any impaired Class of Claims does not vote to accept the Plan, the Court may nevertheless confirm the Plan pursuant to the "cramdown" provisions of section 1129(b) of the Bankruptcy Code. If the Court determines that the Plan "does not discriminate unfairly" and is "fair and equitable" to each Class of dissenting holders of Claims or Interests, the Court may confirm the Plan through "cramdown" with acceptance of at least one impaired Class of Claims.

With respect to each dissenting Class of unsecured Claims, "fair and equitable" means either: (i) the members of each dissenting impaired Class of unsecured Claims receive property of a value, as of the Effective Date of the Plan, equal to the amount of their Allowed Claim; or (ii) the holders of Claims and Interests that are junior to each dissenting impaired Class of unsecured Claims will not receive any property under the Plan.

*5. Absolute Priority Rule*

Simply characterized, the absolute priority rule set forth in section 1129(b)(2)(B) of the Bankruptcy Code requires that confirmation obtained by "cramdown" meet an "either/or" test. Either (i) the members of each dissenting impaired Class of unsecured Claims must be paid in full, or (ii) the holders of Claims and Interests that are junior to each dissenting impaired Class of Claims must not receive any property under the plan of reorganization on account of "such junior interest." The absolute priority rule applies only in cases where a Class of Claims or equity Interests is impaired and does not accept the Plan. Thus, the absolute priority rule does not apply to all Classes of Claims and equity Interests but only to the dissenting Class and Classes junior to the dissenting Class.

The absolute priority rule may apply in this Bankruptcy Case because several Classes of Claims are impaired and entitled to vote.

A more comprehensive discussion of the application of the absolute priority rule and the new value exception contains complexities and subtleties, the explanation of which is beyond the scope of this Disclosure Statement. To the extent a Claim holder or Interest holder desires further explanation regarding such rule or its exception, or any other portion of the Disclosure Statement of Plan, they are advised to seek advice of counsel.

## IV. BACKGROUND OF DEBTORS AND EVENTS LEADING TO BANKRUPTCY

A. History of the Debtors

ReoStar is an oil and gas company incorporated on November 29, 2004 under the laws of the State of Nevada under the name Goldrange Resources, Inc. Effective February 1, 2007, the company changed its name to ReoStar Energy Corporation, after three entities (JMT Resources, Ltd., a Texas limited partnership ("JMT"), REO

Energy, LTD., a Texas limited partnership ("REO"), and BENCO Operating, Inc., a Texas corporation ("BENCO") (JMT, REO and BENCO, are collectively referred to as ("Contributors")) contributed certain assets to Goldrange Resources, Inc. ("Goldrange") in exchange for stock. The Contributors were under common control prior to the transaction, and immediately after the transactions, the former shareholders of the Contributors owned 80.4% of the issued and outstanding stock of Goldrange.

In February, 2007, ReoStar went public and at that time conducted an initial public offering of its stock. ReoStar Gathering, ReoStar Operating, and ReoStar Leasing are all wholly owned subsidiaries of ReoStar Energy. ReoStar Gathering, a Texas corporation, was incorporated on June 25, 2007; ReoStar Leasing, a Texas corporation, was incorporated on July 2, 2007; and ReoStar Operating, a Texas corporation, was incorporated on August 8, 2008. The ReoStar entities shall be referred to collectively as "ReoStar." ReoStars' corporate offices are located at 3880 Hulen Street, Suite 500, Fort Worth, Texas 76107; telephone number (817) 989-7367.

In connection with the transaction, the Company agreed to appoint the following new directors and executive officers: M.O. Rife III, as Chairman of the Board of Directors; Mark S. Zouvas, Chief Executive Officer, President and Director; Brett Bennett, Vice President and Director; Jean-Baptiste Heinzer, Director; and, Alan Rae, Director. Scott Allen was elected to serve as the Chief Financial Officer of ReoStar.

At all relevant times during the events described herein, Zouvas acted as the Chief Executive Officer, President and Director of ReoStar and Allen acted as the Chief Financial Officer of ReoStar. ReoStar has several causes of action as described herein against these parties.

The auditors on the company's transaction going private to public was Killman, Murrell & Co., P.C. out of Odessa, Texas. The Company believes it may have causes of action relating to the audit in connection with going from private to public.

ReoStar Energy Corporation is an upstream oil and gas company engaged in the development and production of non-conventional oil and gas properties with operations primarily focused on known reservoirs and enhanced oil recovery projects. The company is engaged in the exploration, development and acquisition of oil and gas properties, primarily located in the state of Texas. It has historically sought to increase oil and gas reserves and production through internally generated drilling projects, coupled with complementary acquisitions.

At year-end 2010, ReoStar owned approximately 9,000 acres of leasehold, which included 5,000 acres of exploratory and developmental prospects as well as 4,000 acres of enhanced oil recovery prospects. ReoStar has built a multi-year inventory of drilling projects and drilling locations with enough acreage to sustain several years of drilling. Its principal place of business has always been located in Fort Worth, Texas.

Originally, Raymond Lee ("Lee") and Greenberg Traurig, LLP ("GT") acted as counsel for Standard Atlantic, S.A., the investment banking firm responsible for the above transaction. After the transaction closed, Oliver Janssens, on behalf of Standard Atlantic, issued a conflict waiver, and Lee and GT began to act as corporate and securities counsel for ReoStar. At all relevant times during the events described herein, Lee and GT were and acted as outside corporate and securities counsel for ReoStar. Lee worked closely with Zouvas on corporate legal affairs and maintained the corporate books, records and formalities for ReoStar.

B. Debtors' Business Strategy

The Debtors' business objective was to build shareholder value by establishing and consistently growing their production and reserves with a strong emphasis on cost control and risk mitigation. The Debtors' strategy was (1) to control operations of all our leases through their affiliated operating companies, (2) to acquire and develop leasehold in key regional resource development plays while utilizing existing infrastructure and engaging in long-term drilling and development programs, and (3) to acquire leasehold in mature fields and implement enhanced oil recovery programs.

C. Debtors' Significant Accomplishments in Fiscal Year 2010

*Leasehold Acquisition and Development*

(a) Barnett Shale. The Debtors' main area of interest in the Barnett Shale play was located in the "oil window" of the Barnett in southwest Cooke County, Texas. The Debtors completed, and began production in the two wells that were in process as of March 31, 2009.

(b) Corsicana Enhanced Oil Recovery ("EOR") Project. The Debtors entered into negotiations to test a new chemical foam technology that appears to have similar sweep efficiencies as surfactant polymer but at a reduced operational cost. The Debtors expected to deploy the technology in the wells originally drilled for our Phase II of the surfactant polymer project.

(c) Corsicana deeper zone exploration. The Debtors successfully drilled and completed two deeper exploratory wells in the Pecan Gap zone in the Corsicana acreage and expect to continue drilling Pecan Gap on their acreage in Corsicana.

(d) Corsicana technology survey. The Debtors were testing a new technology in the Corsicana field involving the detection and recording of helium atoms through sub-surface sensors that were being placed throughout Debtors' leasehold. The Debtors hoped this technology would assist them in the mapping of the Pecan Gap reservoir and substantially affect the results of subsequent drilling into that zone.

*Concentration in Core Operating Areas*

The Debtors focused in one region: the Southern Mid-continent region of the United States (which included the Barnett Shale of North Central Texas and their Corsicana EOR prospect in East Central Texas). Concentrating on Debtors' drilling and producing activities in these core areas allowed the Debtors to develop the regional expertise needed to interpret specific geological and operating trends and develop economies of scale. Operating developmental projects (such as Debtors' Barnett Shale prospects) and Enhanced Oil Recovery prospects in the same core area allowed Debtors to achieve reserve growth, balanced portfolios between oil and natural gas, and minimize some of the operational risks inherent in Debtors' industry, while leveraging the benefits of the existing infrastructure.

During the 2010 fiscal year, Debtors' wholly owned subsidiary, ReoStar Operating, assumed operations in the Corsicana field.

*Manage Risk Exposure*

Debtors continue to sell a portion of the working interests in the development wells they drill, which allows them to spread the risk by drilling more wells for the same capital expenditure budget.

D. Pre-petition Production, Revenues and Price History Through March 2010

The following table sets forth information regarding oil and gas production, and revenues for Debtors through March 2010.

| Years Ending | March 31, 2010 | March 31, 2009 | March 31, 2008 |
|---|---|---|---|
| Production | | | |
| Oil (Bbl) | 23,949 | 45,105 | 33,602 |
| Gas (Mcf) | 404,131 | 479,180 | 351,538 |
| | | | |
| Revenues | | | |
| Crude Oil | $ 1,613,235 | $ 4,034,376 | $ 2,704,468 |
| Gas | 1,406,275 | 2,523,693 | 2,197,604 |
| Total | 3,019,510 | 6,558,069 | 4,902,072 |
| | | | |
| Average Sale Price per Bbl | 67.36 | 89.44 | $ $80.49 |
| Average Sale Price per MCF | 3.48 | 5.27 | $ 6.25 |

| | | | | |
|---|---|---|---|---|
| Lease Operating Costs (per BOE) | 20.13 | 20.79 | $ | 23.05 |
| Severance Taxes (per BOE) | 1.71 | 3.00 | $ | 3.13 |
| | | | | |
| Average Sale Price (per BOE) | 33.07 | 52.48 | $ | 53.17 |
| Average Sale Price (per MCFE) | 5.51 | 8.75 | $ | 8.86 |

(a) Natural Gas was converted to BOE at the rate of 1 barrel equals 6 MCF.

(E) Summary of Pre-petition Financial Status as of September 2010 with Consolidated Balance Sheet and Consolidated Statement of Operations

During the quarter ended September 30, 2010, the Debtors sold approximately 3,785 barrels of oil compared with approximately 5,080 barrels of oil for the quarter ended September 30, 2009. The average price for oil sold during the quarter ended September 30, 2010 was $72.96 per barrel compared with the average price for the quarter ended September 30, 2009 of $64.16 per barrel.

The Debtors' sold approximately 83,780 mcf of gas for the quarter ended September 30, 2010 compared with approximately 100,075 mcf of gas for the same period a year earlier. The average price for natural gas sold during the quarter ended September 30, 2010 was $5.69 per mcf (net of transportation, compression and CO2 charges) compared with $2.23 per mcf for the quarter ended September 30, 2009.

Oil and gas revenues for the quarter ended September 30, 2010 were $796,972 compared with $556,141 for the three months ended September 30, 2009, an increase of approximately 43%. Oil and gas revenues for the six months ended September 30, 2010 were $1,670,161, compared with $1,174,212 for the six months ended September 30, 2009, an increase of approximately 42%.

Below are the Consolidated Balance Sheets and Statement of Operations through September 2010.

**ReoStar Energy Corporation**
**Consolidated Balance Sheets**

| | **September 30, 2010 (unaudited)** | **March 31, 2010** |
|---|---|---|
| **ASSETS** | | |
| Current Assets: | | |
| Cash | $ 235,602 | $ 277,307 |
| Accounts Receivable: | | |
| Oil & Gas - Related Party | 489,939 | 639,738 |
| Related Party | 848,656 | 561,169 |
| Other | 447 | - |
| Inventory | 118,715 | 130,886 |
| Other Current Assets | - | 248,759 |
| Total Current Assets | 1,693,359 | 1,857,859 |
| | | |
| Notes Receivable | 212,773 | 213,619 |
| | | |
| Oil and Gas Properties - successful efforts method | 26,842,132 | 26,847,329 |
| Less Accumulated Depletion and Depreciation | (10,283,771) | (9,034,348) |
| Oil & Gas Properties (net) | 16,558,361 | 17,812,981 |
| | | |
| Other Depreciable Assets: | 2,028,487 | 2,028,487 |
| Less Accumulated Depreciation | (522,381) | (427,013) |
| Other Depreciable Assets (net) | 1,506,106 | 1,601,474 |
| Total Assets | $ 19,970,599 | $ 21,485,933 |

| | | | |
|---|---|---|---|
| **LIABILITIES** | | | |
| Current Liabilities: | | | |
| Accounts Payable | $ | 408,662 | $ 278,233 |
| Revenue Payable | | 17,104 | 20,912 |
| Payable to Related Parties | | 148,550 | 148,550 |
| Other Current Liabilities | | - | 93,923 |
| Accrued Expenses | | 433,467 | 140,390 |
| Accrued Expenses - Related Party | | 131,861 | 88,458 |
| Current Portion of Long-Term Debt | | 10,447,407 | 10,283,339 |
| Total Current Liabilities | | 11,587,051 | 11,053,805 |
| | | | |
| Notes Payable - Related Parties | | 3,518,924 | 3,518,924 |
| Total Long-Term Debt | | 3,518,924 | 3,518,924 |
| | | | |
| Asset Retirement Obligation | | 345,055 | 324,773 |
| Deferred Tax Liability | | - | 639,034 |
| Total Liabilities | | 15,451,030 | 15,536,536 |
| | | | |
| **Stockholders' Equity** | | | |
| Common Stock, $.001 par,200,000,000 shares authorized and 80,743,912 shares outstanding on September 30, 2010 and March 31, 2010, respectively | | 80,743 | 80,743 |
| Additional Paid-In-Capital | | 11,499,103 | 11,460,893 |
| Treasury Stock, at cost | | (12,240) | (12,240) |
| Retained Deficit | | (7,048,037) | (5,579,999) |
| Total Stockholders' Equity | | 4,519,569 | 5,949,397 |
| Total Liabilities & Stockholders' Equity | $ | 19,970,599 | $ 21,485,933 |

**ReoStar Energy Corporation**
**Consolidated Statements of Operations**

| | Three Months Ended | | Six Months Ended | |
|---|---|---|---|---|
| | **September 30, 2010 (unaudited)** | **September 30, 2009 (unaudited)** | **September 30, 2010 (unaudited)** | **September 30, 2009 (unaudited)** |
| **Revenues** | | | | |
| Oil & Gas Sales | $ 796,972 | $ 556,141 | $ 1,670,161 | $ 1,174,212 |
| Sale of Leases | - | 137,677 | - | 137,677 |
| Other Income | (18,120) | 90,119 | 72,793 | 173,582 |
| | 778,852 | 783,937 | 1,742,954 | 1,485,471 |
| **Costs and Expenses** | | | | |
| Oil & Gas Lease Operating Expenses | 385,849 | 515,195 | 781,854 | 1,043,398 |
| Workover Expenses | 13,680 | 43,998 | 13,680 | 43,998 |
| Severance & Ad Valorem Taxes | 48,109 | 31,129 | 100,691 | 65,195 |
| Geologic & Geophysical | 21,975 | - | 38,494 | - |
| Plugging and Abandonments | 9,030 | - | 17,787 | - |
| Depletion & Depreciation | 707,090 | 684,361 | 1,508,860 | 1,395,927 |
| ARO Accretion | 10,141 | 11,031 | 20,282 | 21,781 |
| General & Administrative: | | | | |
| Salaries & Benefits | 279,851 | 201,935 | 432,937 | 403,495 |
| Legal & Professional | 159,728 | 648,979 | 343,841 | 776,830 |
| Other General & Administrative | 76,165 | 126,406 | 155,870 | 272,371 |

| | | | | |
|---|---|---|---|---|
| Interest, net of capitalized interest of $0 and $132,375 for the three months ended 9/30/10 and 9/30/09, respectively and $0 and $254,273 for the six months ended 9/30/10 and 9/30/09, respectively | 419,955 | - | 419,955 | - |
| | 2,131,573 | 2,263,034 | 3,834,251 | 4,022,995 |
| Other Income (Expense) | | | | |
| Interest Income | 10 | 13,934 | 20 | 27,904 |
| Hedging Gain (Loss) | (34,493) | (103,643) | (15,800) | (103,643) |
| Income (Loss) from continuing operations before income taxes | (1,387,204) | (1,568,806) | (2,107,077) | (2,613,263) |
| | | | | |
| Income Tax Benefit (Expense) | 393,765 | 351,944 | 639,034 | 691,988 |
| Net Income (Loss) | $ (993,439) | $ (1,216,862) | $ (1,468,043) | $ (1,921,275) |
| **Basic & Diluted Loss per Common Share** | $ (0.01) | $ (0.02) | $ (0.02) | $ (0.02) |
| **Weighted Average Common Shares Outstanding** | 80,743,912 | 80,998,912 | 80,743,912 | 80,722,483 |

F. History of the MK, BT, BT International Entities, and Formation of BT & MK

1. *MK Entities* (See Ex. E for Organizational Chart of the MK Entities)

The Michael Kenwood Group (the "MK Group") which operated as a holding company for all of the "Michael Kenwood" branded entities was owned and controlled by Francisco Illarramendi ("Illarramendi")(50.1%), Odo Habeck ("Habeck")(29%) and Ron Percival ("Percival")(20.9%). Illarramendi was the majority owner and a managing member of the MK Group. Habeck served as a managing member of the MK Group's and chief executive officer. Percival served as a managing member of the MK Group. The MK Group maintained its principal place of business at 350 Bedford St., Suite 405, Stamford, Connecticut 06901.

Michael Kenwood Asset Management, LLC ("MK Asset Management") and Michael Kenwood Capital Management, LLC ("MK Capital Management"), entities through which Illarramendi, Habeck and Percival operated the MKG business, are direct subsidiaries of the MK Group.

MK Asset Management is a Delaware limited liability company that was established in or around December of 2006 and is registered to do business in Connecticut. The purported purpose of MK Asset Management was to invest in and manage private equity investments. MK Asset Management principal place of business was also 350 Bedford Street, Suite 405, Stamford, Connecticut 06901.

MK Capital Management is a Delaware limited liability company that was established in or around December of 2006 and is registered to do business in Connecticut. This company is an unregistered investment manager. MK Capital Management's principal place of business was also 350 Bedford Street, Suite 405, Stamford, Connecticut 06901.

In or around December 2010, the MK Group had a thirty-three percent ownership interest in MK Securities Holdings, LLC ("MK Securities"), a registered broker-dealer. The remaining shares of MK Securities were held by Roy Ellis ("Ellis") and Ivan Santillan ("Santillan") through an entity known as ES International, Inc. ("ESI"). Until its separation from the MK Group in December 2010, MK Securities also operated from the MK Group's principal place of business at 350 Bedford St., Suite 405, Stamford Connecticut.

Ellis, Santillan and Thomas Lionelli ("Lionelli") were also at one time employed by MK Consulting. Ellis, Santillan and Lionelli left the MK Group on or around December 2010 and formed Falconview Securities, formerly known as MK Securities.

MK Oil Venture LLC ("MK Oil") shareholders and their purported ownership shares are as follows: Illarramendi (19.4%), Habeck (19.4%), Percival (19.4%), Ellis (19.4%), Santillan (19.4%) and Lionelli (3%).

Illarramendi, Habeck, Percival and other MK Group officers and employees were involved in the formation, management, and financing of the MK Master Investments Funds, LP ("MKMI"), MK Investments, LTD ("MKI") and MK Oil Venture LLC ("MK Oil").

MKMI was owned, controlled and dominated by MK entities. MKMI, a Cayman Islands limited partnership organized in 2008, is a subsidiary of the MK Group. MKMI was formed by MK Capital Management and MK Asset Management. MK Capital Management is MKMI's general partner. MK Asset Management is one of two limited partners of MKMI. The other limited partner is MKI. Habeck, who served as MK Capital Management's President, CEO and member, was involved in conducting MKMI business affairs from MK Capital Management's office in Stamford, Connecticut. MKMI currently holds a private equity investment on behalf of the MK Group (the "Private Equity Investment"). The Private Equity Investment was purchased with funds from MK Asset Management.

MKI, a subsidiary of MK Group, was organized and controlled by MK Capital Management and principals of the MK Group. MKI, a limited partner of MKMI, is an investment fund incorporated in the Cayman Islands as an exempted company on or about March 20, 2008. MK Capital Management holds one hundred management shares in MKI, which constitute the entire voting power of the fund. MKI was managed by substantially the same individuals who manage MK Capital Management. Three of MKI's four directors were Percival, Habeck, and Illarramendi, who were also members of MK Capital Management.

MK Oil was formed for the benefit of MK Group Officers and employees, using funds of MK Asset Management, the MK Group and MK Consulting to finance investments in various oil interests. In total, these entities transferred more than $5.4 million on behalf of, or for the benefit of MK Oil without receiving payment. MK Oil's sole asset is a fifty percent interest of BT & MK, a joint venture with BancTrust International, Inc. ("BT International").

(2) BT International and BT Entities

(a) BT

BancTrust & Co. ("BT") may be a Venezuelan company. It does not appear that it has been registered to do business in the State of Texas or any other State in the United States. BT appears to have an Internet website (www.banc-trust.com) but it contains no information or contact information. Contact information for Christian Lovera ("Lovera") and Cesar Jimenez ("Jimenez") with whom ReoStar dealt on behalf of BT is the same as that of MK Group and MK Capital. BT appears to operate at Four Stamford Plaza, 107 Elm Street, Suite 512, Stamford, CT 06902.

(b) BT International

BT International may be a Venezuelan company. It does not appear that it has been registered to do business in the State of Texas or any other State in the United States. Contact information for Lovera and Jimenz with whom ReoStar dealt on behalf of BT International is the same as that of MK Group and MK Capital. BT International appears to operate at Four Stamford Plaza, 107 Elm Street, Suite 512, Stamford, CT 06902.

(c) BT & MK Entity

BT & MK was originally formed in January 2010 as a joint venture between BT International and MK Asset Management, and not with MK Oil. MK Asset Management paid substantial sums for its fifty percent interest in BT & MK. Several months later, MK Group officers and employees formed MK Oil and used it to misappropriate MK Asset Management's fifty percent interest in BT & MK by creating and executing new joint venture documents for BT & MK that simply replaced MK Asset Management with MK Oil. Neither MK Oil nor its members paid any consideration at the time of the purported transfer.

Even after MK Oil purportedly acquired its interest in BT & MK, MK receivership entities continued to transfer substantial funds for BT & MK investments on MK Oil's behalf. The millions of dollars invested by these MK receivership entities were not returned by MK Oil even though MK Oil now holds the asset. The current purported structure of MK Oil and BT & MK is depicted on Exhibit D, which is attached hereto and incorporated herein by reference. For this reason, MK Oil was added to the SEC Receivership on June 24, 2011.

BT & MK holds two assets: the "Black Pearl" project and the "Reostar Note." The Black Pearl project began as an investment by the MK Group in various sites with potential for oil extraction. BT International offered MK Group a fifty percent interest in a four-site oil exploration and development project.

G. Debtors' Relationship with Union Bank, BT Entities, MK Entities, and BT & MK Entity; The Origins of BT & MK Adversary

1. UB LINE OF CREDIT

In October 30, 2008, the Debtors executed a Credit Agreement for a senior credit facility ("Line of Credit") with Union Bank, with ReoStar as the "Borrower," and ReoStar Gathering, ReoStar Operating and ReoStar Leasing as "Guarantors." The Line of Credit enabled ReoStar, with borrowing base compliance, to borrow up to $25 million to finance drilling operations on its Barnett Shale properties and under its Corsicana leases. Pursuant to the terms of the senior credit facility, the initial borrowing base was set at $14 million and was subject to re-determination every six months with one optional re-determination allowed between scheduled re-determinations. The credit facility was secured by all of the Company's assets and was senior to all other long-term debt. The outstanding principal was due October 30, 2011.

The Credit Agreement defined an "Eligible Assignee" on the Line of Credit as a commercial bank or financial institution, of which BT & MK was neither. And, at Section 9.06, provided an "Assignment" could only be made to an "Eligible Assignee."

After closing, ReoStar initially took advances under the Line of Credit of approximately $8 million, and ultimately borrowed up to $10.8 million. In late 2008 and into 2009, the market price of oil and natural gas sharply declined. As a result, sometime between April and June of 2009, Union Bank froze ReoStar's Line of Credit, due to ReoStar's inability to maintain certain financial covenants under the Line of Credit. However, ReoStar was cash flow positive and continued making its monthly interest payments to Union Bank. Union Bank did not indicate that these non-monetary defaults would trigger immediate acceleration or that it desired to foreclose, and at all times continued to work with ReoStar, accepting payments on the Line of Credit. In fact, Union Bank was willing to allow ReoStar necessary leeway in order to allow the oil and gas market and ReoStar's business to improve, so that the financial covenants under the loan could be met. As such, ReoStar desired injection of capital, and began to search for potential investors.

Carl Stutzman ("Stutzman"), senior vice president and manager, Union Bank, N.A., joined Union Bank as a vice president in March 1989 and was assigned to the Petroleum Group's representative office located in Dallas. His primary responsibilities were new business development and portfolio management for a portfolio consisting primarily of credit facilities to private and public oil and gas E&P companies. In April 1998, Stutzman was promoted to senior vice president and manager of the Petroleum Group. During his tenure, Stutzman and his team have been successful in expanding into new markets and introducing new products and services to position Union Bank as one of the leading providers of capital services to the independent energy sector. Currently, Union Bank has commitments in excess of $5 billion to the oil and gas sector. Prior to joining Union Bank, Stutzman was a banker specializing in oil and gas financing with Hibernia National Bank in New Orleans (1987-89) and MBank Dallas (now JP Morgan Chase) from 1984-87. He has a Bachelor's of Science degree in Business Administration from State University College of New York at Buffalo (1980) and has completed post-graduate work in accounting, finance and banking. Thus, he understood the oil and gas arena, and related lending environment, all to well.

Upon information and belief, Stutzman was instrumental in the Debtors' note moving to the special assets division of the Bank.

As late as October 2009, ReoStar was still current on its payments to Union Bank, and had not received a notice of default or acceleration of the Line of Credit.

On October 19, 2009, Zouvas made an offer to ReoStar's majority shareholders to provide ReoStar with financing for a majority stake in the company.

On October 20, 2009, BT Energy and Commodities, LLC was formed as a Venezuelan company. *See* Receivership Doc. No. 285.

On January 3, 2010, after nothing ever transpired as a result of Zouvas's October 19th offer, the majority shareholders of ReoStar conveyed to Zouvas that they were no longer interested in his proposal, and wanted Janssens and others to focus instead on new capitalization opportunities from third parties.

On January 8, 2010, BT & MK was formed as a Delaware limited liability company between BT International and MK Asset Management, with each holding a fifty percent (50%) membership interest.

2. <u>SEARCH FOR RECAPITALIZATION PARTNERS TURNS TO FRAUD AND BREACH OF DUTY</u>

In connection with its search for new capital, ReoStar worked with several groups known to the Board, including Janssens with Standard Atlantic; Alain Vignon ("<u>Vignon</u>") of Niton Capital Partners, SA (an entity brought in by Janssens); and Grant Swartzwelder ("<u>Swartzwelder</u>") with PetroGrowth Energy Advisors, LLC ("<u>PetroGrowth</u>").[3] It was through Vignon with Niton that ReoStar was introduced to BT.

On February 4, 2010, BT, through its Executive Vice-President Lovera, contacted ReoStar through Vignon and made a proposal for "a majority interest in" ReoStar, but desired immediate contact with Union Bank. Despite the fact no address was provided for BT, and no Confidentiality or Non-Disclosure Agreement (CNDA) was required to be executed (although ReoStar's Chairman and other members of the Board were led to believe one existed), ReoStar responded to this proposal on March 4, 2010 to Lovera. ReoStar understood that, under the proposal, BT was to provide ReoStar with at least $10 million of much needed capital "to develop its reserves," but continued to desire immediate contact with Union Bank prior to a letter of intent or term sheet being presented. BT began its due diligence examination of ReoStar's financial and business books and records. No due diligence, however, was done as to BT and still, no CNDA was required by Niton, Lee, Zouvas or Allen, before BT was allowed to explore and exploit ReoStar's proprietary and confidential business and operational information, which was its ultimate plot.

If due diligence had been performed by Niton, Zouvas, Lee or Allen, they would have discovered that on or about August 5, 2005, after termination of Lovera's employment, Lovera's prior employer, Merrill Lynch, filed an Amended Uniform Termination Notice for Securities Industry Registration ("<u>Form U-5A</u>") with NYSE Regulation, Inc.'s Division of Enforcement ("<u>Enforcement</u>"), which reported a pending customer complaint alleging Lovera engaged in misappropriation of funds and forgery. Lovera's client alleged damages and fees of over $100,000 and the suit was settled by Merrill Lynch for approximately $103,000. A Hearing Officer on behalf of the New York Stock Exchange LLC ("<u>NYSE</u>") considered a Charge Memorandum issued by Enforcement charging Lovera with having violated NYSE Rules 476(a)(11) and 477 by failing to comply with one or more written requests by the NYSE for information regarding activities that occurred during his employment at a member firm. The Hearing Officer found Respondent guilty, and, by order dated May 30, 2007, the Hearing Officer granted the Motion. The Hearing Officer imposed the penalty of a censure and a permanent bar from membership, allied membership, approved person status, and from employment or association in any capacity with any member or member organization. The decision became final as of close of business on June 25, 2007, with the bar against Lovera

3 Zouvas allegedly executed an exclusive agreement with John Calce on behalf of Tritaurian and formed MHR (as defined infra) to obtain new capital for ReoStar, without disclosing the existence of this to the Board.

becoming effective as of the close of business on June 29, 2007.

Despite no CNDA having been executed by BT or any of its agents or representatives, to ReoStar's knowledge,[4] in an email dated March 16, 2010, from Janssens to ReoStar, ReoStar was advised that a "team" from BT would arrive on March 22, 2010, to conduct due diligence with respect to the proposal to become an equity investor in ReoStar.[5]

Just prior to the arrival of the BT due diligence "team," on March 11, 2010, Zouvas as sole manager and Calce as organizer formed Magnolia Hill Resources, LLC ("MHR"), a Texas limited liability company. Upon information and belief, Lee, while acting as corporate counsel for the Debtors, had knowledge of the formation of MHR and its intended purpose. Upon information and belief, the corporate purpose of MHR was to funnel the capital injection from BTMK to ReoStar through it, and funnel other deals for corporate restructuring and recapitalizing opportunities with its new found partner, BT (or MK Capital, or BTMK) for the personal benefit and gain of Calce and Zouvas. Lee/GT was made aware of these intentions, as was BTMK's counsel at Gardere. Neither law firm ever disclosed this conflict of interest.

Also, just prior to the arrival of the so-called "BT due diligence team," by email communication received from Jimenez of BT dated March 17, 2010, ReoStar was advised that BT was partnering with Kenwood Capital and they wanted contact with ReoStar. The Kenwood Capital contacts were Lionelli and Percival. Again, no due diligence was performed on Kenwood Capital nor was a CNDA obtained, despite the ReoStar Board's understanding otherwise.

The BT team" arrived at ReoStar and began its due diligence on or around March 22, 2010. BT conducted extensive due diligence at ReoStar's headquarters. Zouvas, Allen and Lee gave BT representatives access to proprietary and confidential information about ReoStar's gas reserves and business plans involving ReoStar production.

On March 23, 2010, Allen introduced Percival and Lionelli, who represented themselves to be acting on behalf of MK Capital, to Union Bank. On March 29, 2010, Allen, Debtors' counsel with knowledge that no CNDA or background check on MK Capital existed, executed a *Release and Hold Harmless Agreement* (the "Release") on behalf of ReoStar allowing MK Capital to speak directly with Union Bank concerning "a financial transaction between it and Michael Kenwood Capital Management." This document allowed MK Capital to conduct due diligence in evaluating a financial transaction with ReoStar, at a time when no term sheet or letter of intent had been provided or approved by the Board.

At all relevant and pertinent times, the primary negotiators in discussions were Zouvas, Allen and Lee for ReoStar, Calce presumably for Zouvas, and Percival and Lionelli acting on behalf of the Michael Kenwood related entities.

During the fiscal year ended March 31, 2010, the borrowing base was adjusted downward to $7.6 million leaving an over-advance of $3.2 million. It was reported that "the Company lacked the liquidity to repay the over-advance," however, in December, 2009, Zouvas reached a compromise with a creditor and obtained a payoff on a sizeable note owed to ReoStar and instructed Allen to hide the transaction from the ReoStar board. With the help of Allen, Zouvas then made undisclosed and unauthorized transfers to insiders, including Calce and Zouvas's father, rather than using the money to benefit ReoStar's financial situation, at a time when it was insolvent. It is unknown whether other similar transactions occurred and went unreported. To wit, ReoStar was paid $450,000.00 on December 22, 2009 and subsequently wired Mr. Peter Zouvas $203,682.19 (with 56 days of interest) on December

---

4 In the event a CNDA was executed, then ReoStar reserves its right to allege breach of contract causes of action and damages, however, to date, ReoStar has not been able to locate any such agreements in connection with the UB/BTMK transactions at issue.

5 None of the individuals included in the "team" were indicated to have any affiliation with the MK Group or any of the Receivership Parties.

24, 2009. On information and belief, Zouvas also arranged for a payment of $30,000 to be made to Three Bar C, Inc. for services rendered on the fraudulent transaction; Three Bar C is owned by Calce. The Debtors believe they have chapter 5 and other causes of action against Peter Zouvas, Three Bar C, Inc. and Calce based on these transfers.

Around this time, Zouvas and Allen were offered a forbearance arrangement by Union Bank, however, it was not accepted due in part to the $50,000 fee they claim ReoStar could not afford.

On April 20, 2010, MK Oil, another Michael Kenwood related entity and a Receivership Party, was formed as a Delaware limited liability company, on information and belief, to later enable BTMK to purchase the Union Bank Line of Credit with misappropriated funds and as a result of a fraudulently perpetrated scheme upon the investors in the Michael Kenwood entities. *See* Receivership Doc. No. 285.

Following execution of the Release, and shortly after formation of MK Oil, specifically around May 3, 2010, Lionelli and Percival purportedly acting on behalf of MK Capital engaged in private, undisclosed discussions with Mark Zouvas and Union Bank regarding acquisition of the Line of Credit.

Representatives, ostensibly with MK Capital, continued to conduct extensive due diligence at ReoStar's headquarters. These representatives were not only allowed to have private discussions with Union Bank, but were given access to proprietary and confidential information about ReoStar's gas reserves and business plans involving production, without a signed term sheet or letter of intent, but after making representations to ReoStar's Board that it planned to capitalize the company if it purchased the Line of Credit.

ReoStar's Board was told that BT and MK Capital were partnering to make a substantial investment in ReoStar that would allow it to continue drilling operations and future development by providing a capital injection and retiring the Union Bank Line of Credit. While the Board understood, as a part of this process, BT and MK Capital would need to negotiate with Union Bank regarding retiring the Line of Credit, the ReoStar Board did not know BT and MK Capital, acting through and in concert with the Defendants in the BT & MK Adversary Proceeding, were working against ReoStar's interests, to instead acquire the Union Bank Line of Credit at a deep discount (over 50%) and immediately foreclose to gain control of ReoStar's assets.

BT and MK Capital (and, on information and belief, BT & MK thereafter) at all relevant times continued to represent to ReoStar that it was interested in investing in its business and refinancing the Line of Credit for such purposes, only so that it could continue to gain access to valuable proprietary and confidential information about ReoStar's value as a going concern.

It was unknown to ReoStar at this time that Zouvas, BTMK, BT, and the other Michael Kenwood related entities and their principals, named Defendants in the BT & MK Adversary Proceeding, were acting in their own self-interests to usurp and take advantage of corporate opportunities of and from ReoStar by refusing to investigate any alternatives to the supposed investment by BTMK and using information gained under the guise of misrepresentations that it would be investing in ReoStar to save the company, rather than steal it.

On May 14, 2010, ReoStar received a letter from BTMK informing ReoStar of "BTMK's" continued interest "involving the Acquisition of the Notes, Shares or a Combination of the Notes and Shares of ReoStar Energy Corporation." This was the first time ReoStar became aware of the existence of BTMK.

On May 18, 2010, MK Oil replaced MK Asset Management as the other 50% member of BTMK. ReoStar was not aware of these facts at the time of the transaction at issue in this action. ReoStar later learned that BTMK was initially incorporated as BT Energy and Commodities, Inc. on October 20, 2009 and converted to BT and MK Energy & Commodities, LLC on January 8, 2010. BT and MK Asset Management, rather than MK Capital, are shown to be members of BTMK at that time. MK Oil was not formed until April 10, 2010 and was the party that executed the documents associated with the transfer of the Line of Credit from Union Bank to BTMK. ReoStar had no known non-disclosure agreement or other agreement authorizing any Michael Kenwood Group, including MK Oil to access confidential and/or proprietary business and/or financial information relating to ReoStar.

MK Capital, Kenwood Group, MK Oil, BT, and/or BTMK, acting unilaterally and/or in concert, and with the active participation of the individual Defendants to this action, through the commission of a fraudulent scheme on ReoStar, negotiated with Union Bank to acquire the Line of Credit obligation at a significantly deep discount, then failed and refused to provide the promised capital, forcing ReoStar into default and immediately set the collateral securing the Line of Credit for foreclosure.

In fact, BTMK began circulating "Term Sheets" (referred to as Letter of Intent or "LOI") which discussed an injection of resources, payment of subordinate debt, and other deal points that were of significant benefit to ReoStar in late April/early May. The LOIs are signed by BT International, rather than BTMK. It subsequently became clear that BTMK never intended to close the LOI. Despite the intent never to close, BTMK used the negotiation of the LOI to continue to lead ReoStar to believe it was a genuine investor with proper motives.

In June 2010, Zouvas and Allen stopped making the monthly interest payment to Union Bank.

On June 15, 2010, ReoStar executed an engagement letter with PetroGrowth. Swartzwelder immediately began to act on its behalf in locating competitive offers and financing alternatives for the recapitalization of ReoStar. Swartzwelder requested engineer reports, marketing information and financial data, which was not readily, if ever, provided by Zouvas and Allen.

On June 17, 2010, two days later, Swartzwelder had already met with several groups to discuss their interest level in ReoStar, and requested to be present at an upcoming meeting with Union Bank. Zouvas, Allen and Lee, through a series of emails, cut Swartzwelder out of that meeting, and made up untruthful explanations and excuses about why his presence was not timely or appropriate. Zouvas, Allen and Lee admit to "stonewalling" Swartzwelder in an email dated June 18, 2010.

On June 22, 2010, Zouvas, Allen and Lee held a meeting at ReoStar's Fort Worth office with Timothy Hintz ("Hintz") of Union Bank and "made clear that it had no other viable options to raise cash" … "other than an investment from a joint venture formed by Michael Kenwood Group and BancTrust International, Inc., called BT & MK Energy Commodities, LLC ("BT & MK")." *See* Union Bank's July 13, 2010, Report of Administrative Action.

On June 24, 2010, Zouvas stated in an email to Lee, in response to a previous email from Swartzwelder, that retaining Swartzwelder was a "stroke" because, due in large part to Zouvas's and Allen's obstruction of the process, "he has nothing." Zouvas went on to use vulgarities and make threats to harm the ReoStar Board, and further made clear that making the June 30th interest payment to Union Bank, was absurd. Lee never disclosed this or any of the other harmful information contained in the emails from Zouvas, to ReoStar. Likewise, Allen withheld critical information and failed to ever disclose any of the harmful emails from Zouvas, to ReoStar.

On July 5, 2010, Zouvas told Allen and Lee in an email "I don't think we want to say anything to anyone about Union's response to MKBT – we need to get them into an agreement quick and *not give the other team a deadline to get a competing offer* – we can always turn around and sell to them and their "group" for more dollars" (emphasis added). In fact, neither Allen nor Lee ever did "say anything to anyone" as plotted by Zouvas, despite each of their fiduciary duties to act in the best interests of the company and its shareholders and creditors.

In the meantime, Swartzwelder continued to seek proposals, but was careful not to allow any interested third parties to discuss their interest in ReoStar directly with Union Bank, "until an acceptable deal had been reached with the company" – unlike Zouvas and Allen. Swartzwelder stated to Zouvas and Allen on a number of occasions that, having debt purchased without understanding what could happen to the entity was one of his big concerns.

On July 8, 2010, Swartzwelder again emailed Zouvas and Allen to request a dialogue with Hintz of Union Bank, and due to the continual delay tactics of Zouvas and Allen, specifically requested he be allowed to speak with Union Bank by the following day. In an email from Zouvas on July 8, 2010 at 8:00 p.m., Zouvas stated "We have been trading phone calls with Tim at Union and hope to touch base with him soon -- … I do not think it would be appropriate to have you reach out to him without us first understanding the bank's current position on several issues and more importantly, us introducing you into the situation. With respect to the request or need to speak with them by tomorrow, I think we need to have a chat so I can understand the urgency of the matter; we can then decide which route to pursue in the best interests of the Company."

Despite this communication, on July 9, 2010, Zouvas reinforced in a message to Hintz that ReoStar had "no other immediate or viable options to raise cash" other than the investment from the BT &MK joint venture. *See* Union Bank's July 13, 2010, Report of Administrative Action.

While Swartzwelder continues to try and obtain previously requested company information so he can produce a cogent package for investors and implement a comprehensive marketing strategy of the opportunities associated with ReoStar, his efforts are negatively impacted by Zouvas, Allen, Lee, BTMK and Union Bank. On July 20, 2010, Swartzwelder forwarded a written offer to purchase the Union Bank Line of Credit for $6,289,000, by E.G.L. Resources, Inc. Simultaneous to Swartzwelder's ongoing efforts, and unbeknownst to ReoStar, Union Bank accepts BTMK's offer to buy the Union Bank debt for $5,400,000 on July 22, 2010. Hintz advises Lionelli in an email dated July 23, 2010, that the "details of their arrangement should not be disclosed" to Reostar.

In an email dated Sunday, July 25, 2010, at 7:23 p.m., Zouvas discloses to Lee and Calce that BTMK had withdrawn all offers to ReoStar and advised that all the amounts previously due under the credit facility were now due to BTMK and that BTMK planned to proceed with foreclosure of ReoStar's assets. Zouvas directed Calce to "get the offer from EOG and present [it] directly to BTMK." This information was never shared with ReoStar's Board by any of the Defendants.

In communications on July 26, 2010 concerning the timing of the closing of the loan purchase, Lionelli learned from Union Bank representatives that it would need to post for a September foreclosure no later than August 17, 2010, and as such, the closing of the purchase of the credit facility should not go past August 13, 2010.

In emails dated July 28, 2010, between Swartzwelder and Zouvas (copying the ReoStar Board members, Lee and others), Swartzwelder expressed his concerns that (i) BTMK may have a deal with Union Bank before reaching terms with the Company, and (ii) if BTMK has reached a deal with Union Bank, (a) the Company has more than likely lost all leverage with BTMK and (b) the Company will not be able to get another group to fully engage in the process. On July 29, 2010, Zouvas responded in an email by stating that "in every offer submission, their [BTMK's] language clearly, and unequivocally states the offer is contingent on reaching a deal with REOS – it is not their intent to acquire highly specific assets in a complex area under a distressed scenario, quite the opposite, their intent and overall business plan is to establish an operating platform and build a company with assets that can benefit from their extensive O&G experience." Zouvas went on to encourage Swartzwelder to present any offers (but without any intent to actually consider or pursue them).

Thereafter, on August 3, 2010, Zouvas and Allen went to secretly meet with BTMK. Zouvas e-mailed Allen on August 3, 2010 at 7:04 a.m. instructing Allen to assist him in perpetration of the breaches of duty: "I am supposed to have a conference call with JBB [Joe Bill Bennett ("Bennett"), a manager of a major shareholder of ReoStar and party to the LOI] and Trey [M.O. Rife III ("Rife"), Chairman of the Board and a party to the LOI] at 10 this morning. No one is to know we are leaving today. … See you at the airport around 11."

3. UNAUTHORIZED SALE OF NOTE AND ASSIGNMENT OF LIENS

At the same time Zouvas and BTMK were leading ReoStar to believe that BTMK was planning to make an investment in ReoStar, they were also leading Union Bank to believe that Union Bank's collateral (the assets of ReoStar) was of significantly lower value than Zouvas and BTMK actually thought. Zouvas and BTMK were also misrepresenting BTMK's intent to ReoStar by continuing to maintain that BTMK wanted to inject resources into ReoStar when that was neither BTMK's or Zouvas' actual intent. Despite Zouvas's statement on July 29, 2010, copying the Board, that "Their (BTMK) language clearly, and unequivocally states that the offer [to Union Bank] is contingent on reaching a deal with [ReoStar]," in reality, Zouvas and BTMK were executing a "loan to own" scheme to acquire ReoStar's assets at a deep discount, that could then be sold for a higher price to a different "group" or used for their own purposes, with no intention to capitalize operations.

By now, and based on the manipulation of the transaction by Zouvas, Allen, Hintz and the other Defendants, Union Bank had already begun to close with BTMK for an over 50% discount, or roughly $5.4 million. BTMK desired for the closing to occur no later than August 13, 2010, so it could immediately proceed to foreclose. In order to obtain the desired signatures to the consent and LOI in time, Zouvas threatened the Board in an e-mail of August 13 that "we have been informed that Union Bank will file foreclosure papers this coming Monday [August 17, 2010]…" Zouvas knew when he communicated that threat that it was not imminent. Foreclosure by Union

Bank would have effectively cut off ReoStar's ability to partner with new investors because Union Bank, not ReoStar, would now own ReoStar's assets. Zouvas was merely making misrepresentations to ensure that a deal with BTMK, and no one else, was done. In fact, that same day, Zouvas sent a release form to Janssesns requesting Guilford International, Standard Atlantic, Niton, and all others involved waive any current or future claims against ReoStar in connection with the restructuring by BTMK, and stated such release was a significant condition to the LOI. Similar releases with no consideration and without a signed LOI were disseminated by Zouvas to others, with threats the deal would be lost if not signed.

On August 16, 2011, Zouvas forwarded a Consent Agreement to Union Bank, without Board approval.

On August 17, 2010, Union Bank transferred its rights under the $25 million Line of Credit with ReoStar to BTMK *for approximately $5.4 million* (the "Transfer"), without shareholder or Board approval, and to a non-qualifying "Assignee." This was a price that ReoStar's existing shareholders would have gladly paid *to retire the over $11.2 million in debt and to avoid foreclosure*. This was also an amount of money ReoStar could have easily raised through other legitimate investors. In exchange for the approximately $5.4 million in consideration, BTMK was granted an assignment of the liens, deeds of trust, and security interests on all of ReoStar's assets (the "Assignment"), valued at that time by Union Bank to be in excess of $8 million. (The Transfer and Assignment described above are hereinafter referred to collectively as the "Transfers"). No mention of the Transfers was made to the ReoStar Board. Lee/GT were extensively involved in the actions of Zouvas, Allen, and BTMK counsel at Gardere, Tim Spear, and advised each of them with respect to such actions, with knowledge that they had no Board approval for their actions.

Leading up to the August 17, 2010 Transfers, Zouvas forged several documents, including, but not limited to several sets of "Resolutions Adopted by the Board of Directors of ReoStar" stating that the Board authorized and approved the Transfers and execution of that certain Consent Agreement, dated August 17, 2010. In fact, the Board did not even know the Transfers occurred. The Consent Agreement, likewise, was not authorized by the Board, and was executed without authorization, knowledge or approval of the ReoStar Board by: Zouvas for ReoStar, as Borrower, and for ReoStar Gathering, ReoStar Operating, and ReoStar Leasing, each as Guarantors; Hintz for Union Bank; Odo Holland, as CEO for MK Oil, and Jimenez as President for BancTrust.

After the Transfers closed and were recorded, the Board had no choice but to execute the LOI. Thus, on August 23, 2010, the ReoStar Board, under duress, and to get BTMK to agree to a forbearance period until September 30, 2010, executed the LOI. BTMK, however, never had any interest in completing the LOI and ReoStar shareholders and Board members were still being stonewalled by Zouvas from bringing other deals to the table. Instead of attempting to work out a deal with ReoStar which would inject capital into ReoStar, BTMK immediately moved to foreclose on the Line of Credit.

4. BTMK SENT FORECLOSURE NOTICE 44 DAYS AFTER LOAN PURCHASED

On October 1, 2010, one day after the short forbearance period expired on September 30, 2010, BTMK through counsel at Gardere, sent an acceleration demand providing notice that it was accelerating the note due to the interest payment default. On October 12, 2010 BTMK through counsel at Gardere sent notice of foreclosure to ReoStar, indicating BTMK intended to foreclose on the assets of the Company if payment in full was not made by November 2, 2010. This was a complete surprise to ReoStar which had negotiated and provided information to BTMK so that BTMK could become an equity investor. At all times prior to the Transfers, Zouvas had continuously represented to the Board that BTMK purchasing the Line of Credit was "contingent on reaching a deal with [ReoStar]." Instead, BTMK used ReoStar's information to value the company and then surreptitiously buy the debt and obtain the Assignments at an over 50% deep discount without ReoStar's knowledge, but with the full knowledge of Zouvas, Allen, and Lee. Upon information and belief, BTMK, Zouvas, Allen and Lee believed, at the time it offered the bogus valuation information to Union Bank, that the value of the liens were in excess of $10.8 million. *See* Motion to Temporarily Allow Claims Doc. No. 208.

At all relevant times prior to the Transfers, Zouvas, with the aid of Allen, blocked any other deals brought to the table by telling Bennett and Rife and other Board members, that presenting other deals to Union Bank would be a breach of the CNDA and/or LOI. Zouvas also told other investment bankers engaged by ReoStar to find a buyer to "hold off" on bringing deals other than BTMK's to Union Bank. In reality, Zouvas was just trying to protect BTMK and to prevent any other bidders from offering a better deal to ReoStar. Lee/GT and Allen failed to properly and appropriately advise Zouvas with respect to actions taken, or disclose them to ReoStar's Board or shareholders, and were all aware that his actions were *ultra vires* and/or were not in the best interests of ReoStar.

BTMK, acting in concert with the Defendants, got the result it wanted. It was able to make ReoStar believe (with the help of Zouvas) that it was interested in becoming a ReoStar investor so that it could obtain confidential, proprietary information. Zouvas, Allen and Lee, at some point early in the negotiations with BTMK, stopped acting in ReoStar's best interest and began making decisions and disclosures (or lack of disclosures) in their own best interests. Ultimately, BTMK used this information to buy the Line of Credit at a price it knew it could turn a profit for and immediately set to foreclose on the assets of ReoStar. Zouvas benefitted from this because he had cut a deal with BTMK which provided that he would be employed by BTMK after the transaction and BTMK gained control of ReoStar through foreclosure of the lien securing the Line of Credit, but had no such assurances from any other potential buyer. Upon information and belief, Zouvas and Calce (through MHR) also had an agreement with BTMK to obtain a significant fee for the restructuring of ReoStar, if they could get the others engaged to do same to waive their right to payment under their contracts.

On September 28, 2010, Zouvas and Allen were formally removed from ReoStar's Board by written action pursuant to ReoStar's bylaws of the requisite amount of shareholders.

On October 5, 2010, Zouvas and Allen each resigned from the Board of Directors of ReoStar Energy Corporation.

On November 1, 2010 the Debtors' were forced to file chapter 11 to avoid the foreclosure of BT & MK. Zouvas resigned as an employee of ReoStar effectively on or about November 15, 2010.

5. BTMK PRINCIPALS PLACED IN SEC RECEIVERSHIP LESS THAN 5 MONTHS LATER, REVEALING UB LOAN PURCHASED WITH MISAPPROPRIATED FUNDS

On January 14, 2011, Illarramendhi and MK Capital were named as defendants in the Complaint filed by the John J. Carney ("Receiver"), and MK Asset Management, MK Energy and MKEI were named as relief defendants. *See* Receivership Doc. No. 1. The Order Appointing Receiver was entered on February 3, 2010. *See* Receivership Doc. No. 66. On June 22, 2011, the Court entered an Amended Order Appointing Receiver. [See Doc. 279]. On June 29, 2011, John J. Carney ("Receiver") filed a Motion for an Order Expanding the Receivership to Include MKMI, MKI and MK Oil. On July 5, 2011, MK Oil was added in all respects to the Receivership, s*ee* Order Expanding Receivership at Receivership Doc. No. 287, so that "the Receivership's interest in BTMK is properly recognized in the ReoStar bankruptcy action and so the Receiver may properly defend the adversary proceeding on behalf of MK Oil[6]. Otherwise, Reostar and other parties to the Reostar bankruptcy proceeding may have the ability to dispose of Receivership Property without proper consideration for the Receiver's interest in the Reostar Note." *See* Motion to Expand Receivership at Receivership Doc. Nos. 285, p. 8.

The Receiver alleges that MK Oil obtained the funds to purchase the Reostar Note through receipt of fraudulently obtained funds. The Receiver alleges fraud, deceit, violation of federal securities laws, misappropriation of funds, and deliberate or reckless disregard of regulatory requirements against Illarrmendi, the MK Group, the other MK entities they controlled, and each of their officers and directors, which includes Lionelli and Percival. It is the Receiver's position that all "Receivership Entities" were deeply intertwined and acted as the alter egos of each other in the fraudulent schemes perpetrated by the MK Group. *See* Docket No. 285, generally and at p. 2.

On March 7, 2011, Illarramendhi "pleaded guilty in the criminal cases against him to two counts of wire fraud, one count of securities fraud, one count of investment advisor fraud, and one count of conspiracy to obstruct justice, conspiracy to obstruct an official proceeding and conspiracy to defraud the SEC. *Id*. at fn. 3.

---

6 It is unclear at this point whether Lionelli has authority to make decisions for BT & MK as MK Oil's interest in BT & MK are owned by the Receiver.

As such, it is without doubt, that the Receivership Entities and their principals and agents, perpetrated a fraud on the Debtors as described herein.

6. DEBTORS FILE ADVERSARY

1. Background

On February 27, 2011, the Debtors commenced an adversary proceeding against BT & MK and Zouvas, its former CEO alleging, inter alia, that BT & MK had conspired with Zouvas and knowingly participated in his breach of fiduciary duty to the Debtors by acquiring the Line of Credit for a deep discount and then immediately attempting to foreclose its security interest in ReoStar's and affiliates' assets. *See ReoStar Energy Corp. v. BTMK and Zouvas*, Adv. Proc. 11-4022-dml (N.D. Tex. filed February 27, 2011)("BT & MK Adversary Proceeding"). The BT & MK Adversary Proceeding was amended on June 22, 2011 to add MK Oil, MK Group, MK Capital, as well as former Kenwood related principals Ronald Percival, Thomas Lionelli, and others, alleging that they also knowingly participated in a breach of fiduciary duties owing to ReoStar. *See ReoStar Energy Corp. v. BTMK, et al.*, Adv. Proc. 11-4022-dml (N.D. Tex. filed June 22, 2011).

The nature and basis of the adversary[7] are as follows: based on BT & MK's improper and inequitable strategy to acquire the Debtors' assets, aided and abetted by the fraudulent actions by the other Defendants, as more specifically alleged in this Adversary Proceeding, Debtors' seek in this action, *inter alia*, a declaratory judgment: (i) recharacterizing all or part of BT & MK's alleged secured debt as equity; (ii) equitably subordinating all or part of BT & MK's claims; (iii) setting aside BT & MK's liens for the benefit of the estate; (iv) awarding damages, either as set off against BTMK's and the other Defendants' claims or for monetary relief in favor of the Debtors for: (a) breaches of Defendants' fiduciary duties of loyalty and care; (b) aiding and abetting breaches of the Debtors' officers and Board member's fiduciary duties of loyalty and care; (c) fraudulent inducement and conspiracy; (d) knowing participation in the breach of fiduciary duties of others; (e) negligence; and (f) gross negligence; (v) avoiding fraudulent transfers received by BT & MK and Union Bank; (vi) avoiding preferential transfers received by BT & MK and Union Bank; (vii) disallowing all or part of BT & MK's claims; (viii) avoiding all or part of BT & MK's liens; (ix) ordering turnover of all avoided transfers; and (x) awarding all other and necessary relief, including compensatory damages, exemplary or punitive damages, interest, attorneys fees, and costs.

Claims asserted or to be asserted, include but are not limited to, recharacterization of debt to equity, equitable subordination of claims and setting aside of liens under section 510 (c), turnover under sections 542 and 543, avoidance and recovery of fraudulent transfers under section 544, 548 and 550, avoidance and recovery of preferential transfers under sections 547 and 550, negligence, gross negligence, breach of fiduciary duties, conspiracy, fraudulent inducement and fraud. The Defendants, and other parties mentioned herein that are sought to be added to the BTMK adversary, after appropriate leave of Court is obtained from this Bankruptcy Court and in the SEC Receivership from the Connecticut District Court, all presumably dispute these allegations.

2. Adversary Parties

Plaintiff

a. ReoStar is the Plaintiff and Debtor-In-Possession in the above-styled and referenced jointly administered bankruptcy cases (collectively, the "Case")[8].

---

[7] The nature and basis and parties section are based on a third amended petition, which is incorporated by reference herein as if set forth herein verbatim, the Debtors plan to seek leave from this Court and the Connecticut District Court to file. The Motions for Leave were filed on August 1, 2011 [Adv. Doc. No. 44], and August 3, 2011 [Receivership Docket No. 295], respectively.

[8] *In re ReoStar Energy Corporation*, Case No. 10-47176 ("ReoStar" or the "Debtor"), *In re ReoStar Gathering, Inc.,* Case No. 10-7198 ("ReoStar Gathering"), *In re ReoStar Leasing, Inc.*, Case No. 10-7201 ("ReoStar Leasing"), and *In re ReoStar Operating, Inc.*, Case No. 10-7203 ("ReoStar Operating") (ReoStar, ReoStar Gathering, ReoStar Leasing, and ReoStar Operating, collectively referred to as the "Debtors") are Jointly Administered Cases under Case No. 10-47176.

Defendants

b. BTMK is a Delaware limited liability company, formed on January 8, 2010. BTMK is a creditor in the Case, having filed Proofs of Claim Nos. 10, 1-1, 1-1, 2-1 in each of the Debtors' respective cases. As such, BTMK has consented to the jurisdiction of this Court.

c. Zouvas is a creditor in this case, having filed Proof of Claim No. 20 in ReoStar's Case. As such, Zouvas has consented to the jurisdiction of this Court.

d. Allen is an individual residing in the State of Texas. Allen is the Debtor's former chief financial officer.

.

e. On information and belief, Illarramendi is an individual residing in the State of Connecticut. On information and belief, Illarramendi is the subject of a receivership action styled *Securities and Exchange Commission v. Francisco Illarramendi and Michael Kenwood Capital Management, LLC*, pending in the United States District Court for the District of Connecticut, Civil Action No. 3:11-cv-00078-JBA (the "Receivership"). For this reason and to the extent this party is covered by the Receivership, service of Amended Complaint and Summons will be made on the Receiver John J. Carney (the "Receiver"), at Baker Hostetler LLP, 45 Rockefeller Plaza, New York, NY 10111[9] after filing a motion for leave in the Receivership with the Connecticut District Court.

f. On information and belief, MK Group is a limited liability company formed under the laws of the State of Delaware and may be served with Summons and a copy of this Amended Complaint by serving its registered agent Corporation Service Company at 2711 Centerville Road, Suite 400, Wilmington, Delaware. Further, on information and belief, MK Group may be the subject of a receivership action styled *Securities and Exchange Commission v. Francisco Illarramendi and Michael Kenwood Capital Management, LLC*, pending in the United States District Court for the District of Connecticut, Civil Action No. 3:11-cv-00078-JBA (the "*Receivership*").

g. On information and belief, MK Capital is a limited liability company formed under the laws of the State of Delaware. Further, on information and belief, MK Capital may be the subject of the Receivership action styled *Securities and Exchange Commission v. Francisco Illarramendi and Michael Kenwood Capital Management, LLC*, pending in the United States District Court for the District of Connecticut, Civil Action No. 3:11-cv-00078-JBA.

h. On information and belief, MK Oil is a limited liability company formed under the laws of the State of Delaware Further, on information and belief, MK Oil may be the subject of a receivership action styled *Securities and Exchange Commission v. Francisco Illarramendi and Michael Kenwood Capital Management, LLC*, pending in the United States District Court for the District of Connecticut, Civil Action No. 3:11-cv-00078-JBA (the "*Receivership*").

i. On information and belief, MK Asset Management is a limited liability company formed under the laws of the State of Delaware. Further, on information and belief, MK Oil may

---

9 Several Michael Kenwood related individuals and entities are implicated in this action, including Illarramendi, The Michael Kenwood Group, LLC, Michael Kenwood Capital Management, LLC, Michael Kenwood Asset Management, LLC, and MK Oil Ventures, LLC (the "Receivership Parties"). There may be other Michael Kenwood related entities involved. As such, ReoStar reserves the right to add additional Michael Kenwood/Receivership Parties to this action as discovery progresses.

be the subject of a receivership action styled *Securities and Exchange Commission v. Francisco Illarramendi and Michael Kenwood Capital Management, LLC*, pending in the United States District Court for the District of Connecticut, Civil Action No. 3:11-cv-00078-JBA (the "*Receivership*").

j. ReoStar has been unable to locate an entity by the name of BancTrust & Co. which was or has been formed in the United States. It is possible that it is a Venezuelan company. It does not appear that it has been registered to do business in the State of Texas or any other State in the United States. ReoStar has never been provided a specific mailing address for BT. BT appears to have an Internet website (www.banc-trust.com) but it contains no information or contact information. Contact information for Lovera and Jimenez with whom ReoStar dealt on behalf of BT is the same as that of MK Group and MK Capital.

k. ReoStar has been unable to locate an entity by the name of BancTrust International, Inc. which was or has been formed in the United States. It is possible that it is a Venezuelan company. It does not appear that it has been registered to do business in the State of Texas or any other State in the United States. ReoStar has never been provided a specific mailing address for BT International. BT International signed the term sheets which are discussed above. On information and belief, contact information for Lovera and Jimenez with whom ReoStar dealt on behalf of BT and BT International is the same as that of MK Group and MK Capital

l. Lionelli is an individual. At all times relevant he was and is associated with the Michael Kenwood and BTMK related entities which are the subject of this action as an officer.

m. Lovera is an individual who is, on information and belief, associated with BancTrust & Co. Lovera provided ReoStar with his address in the United States.

n. Jimenez is an individual who is, on information and belief, associated with BT. ReoStar believes his business address in the United States.

o. Calce is an individual residing in the State of Texas. He is associated with Magnolia Hill Resources, LLC, a company established by Zouvas to facilitate his anticipated involvement with BTMK, and Tritaurian, another company Zouvas contracted with, without Board approval, for investment banking services, including seeking financing alternatives.

p. Percival is an individual.

q. Lee is an individual residing in the State of California. Lee acted as outside corporate and securities counsel for ReoStar. Lee worked closely with Zouvas on corporate legal affairs and maintained the corporate books, records and formalities for ReoStar.

r. GT is a limited liability partnership with offices located, inter alia, in Dallas, Texas and San Francisco, California. Lee and GT were and acted as outside corporate and securities counsel for ReoStar.

s. Tritaurian has entered an appearance in this action. Tritaurian was controlled at all pertinent times by Calce, who is also a Defendant in this Adversary Proceeding. Tritaurian is a creditor in the Case, having filed Proof of Claim No. 19-1 in ReoStar's case. As such, Tritaurian has consented to the jurisdiction of this Court.

t. Niton Capital Partners SA is another named Defendant within the BT & MK Adversary Proceeding.

u. Union Bank is a national banking association with its headquarters located in California.

H. Causes of Bankruptcy Filing

The main cause of the bankruptcy filing is described in great detail above. In addition for the reasons stated above, Zouvas had ceased making interest payments to Union Bank. ReoStar began exploring options to restructure its business and/or financial obligations. ReoStar was introduced to BT by and through certain of Debtors' foreign shareholders and members of its Board of Directors, as a potential buyer of the operating assets of the Debtors and its affiliated entities, thereby allowing the Debtors and its affiliates to be relieved from the Union Bank indebtedness. BT indicated a desire to acquire at least 90% ownership of ReoStar and its affiliates. BT sent not less than twelve (12) engineers and attorneys to ReoStar Energy's offices to conduct due diligence. ReoStar turned over everything it owned, including confidential geological information, to BT to facilitate its due diligence examination. BT also understood that the Debtors owed Union Bank approximately $10,800,000 at the time; however, BT indicated it was not concerned with the Debtors' monetary obligations to Union Bank because it was interested in acquiring a majority ownership in the companies. BT then formed a relationship with MK Group, LLC, a private equity firm. BT and MK joined forces and created BT & MK.

Without Debtor's knowledge or consent, BT & MK, with the knowledge and information gained by BT through its supposedly private and confidential due diligence investigation of the Debtors, commenced direct negotiations with Union Bank to acquire the Note, which was secured by a lien on substantially all of the Debtor's assets. In June or July 2010, the Debtors went into non-monetary default under the Note. It began negotiations with Union Bank toward a possible restructure of the indebtedness.

In August 2010, the Debtors learned that BT & MK acquired the Note from Union Bank at an approximate 50% discount. The Note, related transactional instruments and collateral rights thereunder, including the Deed of Trust, were acquired by BT & MK through a purchase, sale and assignment transaction that closed on or around August 17, 2010. The Note was acquired by BT & MK for approximately $5.4 million, significantly less than the face value of the Credit Agreement and well under the amount outstanding on the Note at the time ($11.2 million plus accrued interest). BT & MK started immediately pursuing payment on the Note, which by this time the Debtors wherein covenant default thereof.

Within weeks of the closing on the acquisition of the Note, the communications between the Debtors and BT & MK ceased. On October 1, 2010, BT & MK (having held the Note less than 2 months) accelerated the indebtedness under the Note. By letter dated October 12, 2010, BT & MK provided notice to the Debtors that it had posted the real property securing repayment of the Note and other collateral for foreclosure on November 2, 2010. By letter dated October 22, 2010, BT & MK made demand on certain entities to forward all proceeds derived from the sale of oil and gas covered by its Deeds of Trust and assignment of production. When Debtors were unable to gain resolution of their financial issues with BT & MK, Debtors contacted Bruce Akerly with Cantey Hanger LLP for representation and possible bankruptcy filing in order to prevent foreclosure of the Deed of Trust with BT & MK.

I. BTMK's Lift Stay Motion and Debtor's Motion to Consolidate

BTMK filed a Motion to Lift the Automatic Stay [Docket No. 60] And Brief In Support ("BTMK Lift Stay Motion") in th Bankrutpcy Case. The Court denied BTMK's Lift Stay Motion[10]. The Court stated (a) in the Letter Ruling that "…I will, however, reconsider if the Motion ***is re-filed by both*** BTMK and the Receiver…." (emphasis added) and (b) in the Lift Stay Order "….the court will reconsider its ruling respecting the Motion ***if the Motion is jointly filed by BTMK and John J. Carney, Receiver*** for the Michael Kenwood Group" After the Receiver conducts an appropriate investigation of the actions of BTMK (emphasis added). The BTMK Adversary and the BTMK Lift Stay Motion both involve (1) common parties such as the Debtors and BTMK and (2) common facts regarding the validity and amount of BTMK's claims. The only way to determine the amount of BTMK's claim and whether BTMK is adequately protected, is to allow the consolidation of the Adversary Proceeding and the BTMK Lift Stay

---

10 *See* Judge Lynn's Letter Ruling Dated July 26, 2011, at page 3 [Docket No. 237] ("Letter Ruling") and Order Denying Without Prejudice Motion for Relief From Stay [Docket No. 60] ("Lift Stay Order").

Motion. The Court also recognized that John J. Carney, Receiver for the Michael Kenwood Group, ("Receiver") controls half of the BTMK claim and that the conduct alleged by the Debtors is consistent with the reasons for the Receiver's appointment.

There is compelling evidence for the Debtors' claims for equitable subordination, lien avoidance, fraud and other claims in Third Amended Complaint and Request for Declaratory Relief, for which leave is sought. Recall, the heart of the Debtors' adversary proceeding against BTMK and others is that several defendants conspired against the Debtors to purchase the Debtors' secured debt at a deep discount and then foreclose upon the Debtors' assets, but did so under the auspices of attempting to recapitalize the Debtors (i.e., not kill them). Now, the Receiver purports he "has completed a sufficient investigation to understand the circumstances surrounding the acquisition of the note and assess the legitimacy of the transaction" and that "BTMK negotiated in good faith" and "BTMK maintained its interest in acquiring an 80% equity interest in ReoStar" even as late as August 23, 2010. *See* BTMK Lift-Stay Notice, Exhibit A, p.2, 5, and 4, respectively.

However, contrary to the Receiver's self-interested "investigation," BTMK's own email production has sustained the Debtors' allegations against them:

From: Thomas Lionelli [MK Group]

Sent: Wednesday, **March 10, 2010** 10:44 AM

To: 'JIMENEZ, Cesar' [Banc-Trust]; 'cjimenez@bankc-trust.com' [Banc-Trust]; Ron Percival [MK Group]

Cc: 'clovera@banc-trust.com' [Banc-Trust]

Subject: RE: Due Diligence in Texas

Cesar,
I just learned that ReoStar is in default on its debt with Union Bank. The text of a February 17, 2010 8-K disclosure statement is provided below. This could have very important implications for the deal. For example, we may want to negotiate with the bank rather than the Company. **If we own the debt (which we may be able to acquire at a discount) we can consider foreclosing on ReoStar (force them into bankruptcy).** That is not a strategy I know much about, but it might have some bearing on pricing. Alternatively, we could tell the bank that we will only buy ReoStar if they forgive some of the debt.
I need to share this information internally to see if it affects our appetite to pursue the investment.
Any light you can shed on this would be helpful.
Regards,
Tom
*****

Clearly, by BTMK's own internal documents, BTMK was intent in owning the Debtors' debt and foreclosing upon them (or forcing them into bankruptcy), not re-capitalizing the Debtors or owning their equity in lieu of debt. Indeed, email correspondence as late as August 2010 indicates that BTMK and other Defendant conspirators clandestinely continued to keep foreclosure at the forefront of their minds:

From: Thomas Lionelli

Sent: Friday, **August 13, 2010** 5:14 PM

To: Francisco Illarramendi; Odo Habeck; Ron Percival; Roy Ellis – MKSEC; Ivan Santillan - MKSEC

Subject: ReoStar

*****

> Finally, we do not need to finalize negotiations with Rife and Bennett before buying the note. In fact, **our hand strengthens if we own the note because we can initiate foreclosure proceedings and Rife and Bennett would lose their debt and equity**.
>
> Let me know if you have any comments.
>
> Regards,
>
> Tom

And in an August 14, 2010 email from Lionelli to Percival and others, he states "Finally, if the term sheet is not consummated by August 31st and there are no buyers for the Note within 30 days, then BTMK is at liberty to foreclose on the Note."

Other BTMK-produced emails reflect the Defendants' intent to associate together in an "alliance" to benefit from ReoStar's loss and misplaced faith in the Defendants' misrepresentations. For example, in an April 23, 2010 email from Defendant Mark Zouvas to each of the above-named co-conspirators, Jimenez, Lionelli, Percival, Lovera, and adding John Calce and Raymond Lee, but not copying any ReoStar directors, he states "I think we can all form an alliance that will be mutually beneficial and ultimately begin to bring tremendous value to our respective companies.".And in an April 27, 2010 email from Percival to Lionelli, they refer to having their "rehearsed conversation" with [Reostar] counsel. Most blatantly, in a March 23, 2010 email from Lionelli to Percival, Lionelli thought they should mention in their memo describing the outcome of BTMK's due diligence at ReoStar's offices, that "**[ReoStar's] management was very open (to a fault) and trusting**" of BTMK (emphasis added).

These emails raise some serious questions as to the integrity of the Receiver's investigation. The Debtors' have moved for the BTMK Lift Stay Motion to be consolidated with the BTMK Adversary [Docket No. 317]. .

J. Chapter 11 Operations

*1. Chapter 11 Highlights*

The chapter 11 process for the Debtors has focused on (a) prudent use of their cash while focusing on marketing and sales efforts, (b) cooperation with the Court-appointed Examiner as detailed below and (c) coming to an agreement with its CoPlan Proponent, Russco, so that the value of Debtors' assets could be realized outside of a forced liquidation or a sale for which the Debtors could not obtain operating value as a going concern.

*a.* *Use of Cash Collateral* – On November 4, 2010, the Court held a hearing on the Debtors' use of cash collateral to operate its business. On that day, and subsequent thereto, on December 6, 2010, January 4, 2010 and March 7, 2011, the Bankruptcy Court entered orders extending use of cash collateral through July 7, 2011. Through subsequent agreement reached with BTMK's counsel, subject to a reservation of rights, Debtors' have secured continuing use of cash collateral. The next hearing on cash collateral is set for hearing on October 17, 2011.

During these hearings, the Court appointed Mike McConnell as Examiner. Mr. McConnell is hereinafter referred to as "the Examiner."

*b.* *Examiner* – On or about February 10, 2011, the Examiner completed and filed his Statement of Investigation (the "Examiner's Report") **[Docket No. 93]**. The Debtors would point Creditors to the Conclusions section, set forth in the Examiner's Report, which are set forth below:

> "The Court directed the Examiner to investigate and report to the Court on (1) the status of current assets and current liabilities and the desirability of continuing current operations, and (2) the prospects for the Debtors' reorganization, including the advisability of asset sales. With respect to the first group of issues, the company is operating on a current basis at a "break-even" basis with no monthly debt service. There are no funds available for drilling, acquisition or exploration and no funds are available under the Senior Credit Facility. Current operations can continue at this

> level but there are little or no internally-generated funds available for development or reworking operations.
>
> With respect to the second group of issues, from the data provided by ReoStar and its subsidiaries, it is obvious to all parties that these companies cannot reorganize on a stand-alone basis. The assets must either be sold or there must be a very substantial equity infusion from third-parties. While there may still be opportunities for recapitalization, the company does not have the luxury of unlimited time. Any development is currently held in check for lack of funding and any future significant operational problem will cause an immediate operational loss. The Examiner is unaware of any current formal recapitalization proposal. In the absence of any current recapitalization proposal, the most viable option is a sale of assets.
>
> Accordingly, the Examiner first recommends that the offer to purchase the ReoStar interest in the Ford No. 1 well should be acted upon immediately. Second, the Corsicana properties should be marketed and sold independently of any sale process for the Barnett Shale properties, although this would not foreclose a combined sale if it ripened. Third, a formal marketing process for the Barnett Shale properties should begin promptly, under the guidance of qualified marketing professionals, to adequately test the market for the ReoStar Barnett Shale properties and obtain market value of the assets. The current Venro offer or a favorable offer from ConocoPhillips could serve as a basis, with appropriate buyer protection, for this effort."

Based on the Examiner's conclusions, the Debtors made a diligent effort to secure a recapitalization proposal and an equity infusion. The Debtors were successful in their endeavors, despite the limited time they had, in securing exit financing and significant capital funding, including equity infusions from new and old equity owners vital for drilling, acquisition, exploration, development and reworking operations. The Plan is based on this funding, which is described in the Plan Projections attached as Exhibit "B" hereto, in the schedule entitled "Plan Sources and Uses of Capital Funding," attached to the Plan Projections, and in the Term Sheet attached as Exhibit "F" hereto. This recapitalization is the basis of the Plan that is being proposed.

*2. Claims Objections and Equitable Subordination of Claims Requested in the Plan*

*a. BT & MK, Zouvas and Tritaurian Capital*

BT & MK has filed a Claim against ReoStar Energy **[Claim No. 10]**, ReoStar Gathering **[Claim No. 1]**, ReoStar Leasing **[Claim No. 1]**, and ReoStar Operating **[Claim No. 2]**, in each of their respective Bankruptcy Cases ("BT & MK Claims"). Each of the Claims relate to the subject matter of the BT & MK Adversary Proceeding. The Debtors have filed objections to each of these claims for the reasons set forth in the BT & MK Adversary Proceeding ("Claims Objections") and the Debtors' complaint, and the Debtors have requested that the Bankruptcy Court determine the extent that BT & MK's Claims are secured under section 506(a)(1) of the Bankruptcy Code and Bankruptcy Rule 3012. The Debtors have requested that BT & MK Claims be equitable subordinated. *In re Cajun Electric Power Cooperative, Inc. (Official Committee of Unsecured Creditors v. Cajun Electric Power Cooperative, Inc.)*, 119 F.3d 349, 357 (5th Cir.); *In re Herby's Foods, Inc. (Summit Coffee Company v. Herby's Foods, Inc.)*, 2 F.3d 128, 130 (5th. Cir. 1993)(holding that equitable subordination is justified only if (1) the claimant engaged in inequitable conduct, (2) the misconduct resulted in injury to the creditors or conferred an unfair advantage on the claimant and (3) equitable subordination of the claim would not be inconsistent with the provisions of the Bankruptcy Act (now "Bankruptcy Code")[11]. The Debtors reserve the right to request that BT & MK disgorge and return to the estate all adequate protection payments made upon a final determination of its Claims in the BT & MK

[11] The Court noted that three additional principles must be considered: (1) the inequitable conduct by the claimant may be sufficient to warrant subordination whether or not the misconduct related to the acquisition of or assertion of the claim, (2) a claim should be subordinated only to the extent necessary to offset the harm that the bankrupt and its creditors suffered as a result of the inequitable conduct and (3) the claims arising from the dealings between the debtor and its fiduciaries must be subjected to rigorous scrutiny, and, if sufficiently challenged, the burden shifts to the fiduciary to prove both the good faith of the transaction and its inherent fairness. *Herby's*, 2 F.3d at 131. Inequitable conduct does encompass (1) fraud, illegality, breach of fiduciary duties, (2) undercapitalization and (3) the claimant's use of the debtor corporation as a mere instrumentality or alter ego. *Id.*

Adversary Proceeding.

Zouvas filed proof of Claim No. 20 ("Zouvas Claim"). The Debtors request that the Court equitable subordinate the Zouvas Claim under 11 U.S.C. § 510(c)(1) and or (2) because Zouvas was an insider and engaged in inequitable conduct.

Tritaurian Capital, Inc. filed proof of Claim No. 19 ("Tritaurian Claim"). The Debtors request that the Court equitable subordinate the Tritaurian Claim under 11 U.S.C. § 510(c)(1) and or (2) because the claimant engaged in inequitable conduct.

The Claims Objections have been consolidated with the BT & MK Adversary. The Debtors have requested that the Court equitably subordinate the following claims as follows:

(a) Any portion of the BT & MK Claims that is equitably subordinated under 11 U.S.C. §510(c)(1) and/or (2) in the BT & MK Adversary Proceeding shall not receive a distribution under this Plan.

(b) The Zouvas Claim be equitably subordinated under 11 U.S.C. §510(c)(1) and/or (2) and shall not receive a distribution under this Plan and that the Zouvas claim be disallowed in full.

(c) The Tritaurian Capital Claim is equitable subordinated under 11 U.S.C. §510(c)(1) and/or (2) and shall not receive a distribution under this Plan and that the Tritaurian Capital Claim be disallowed in full.

*b. Breithaupt*

The Debtors filed an objection to Claims Number 14 through 16 filed by creditors J.A. Breithaupt III (Claim #14), Claudia Breithaupt Childress (Claim #15), James McCabe (Claim #16) and Martha Bendand (Claim #17). These claims are unliquidated claims that relate to a state court case filed in 2007 against the Debtors and others in a case styled I.A. Breithaupt, III, Claudia Breithaupt Childress, and Becky McCabe v Texas M.O.R. Inc., a Texas corporation, Moroil, Inc., a Texas Corporation, JMT Resources, LTD, Reostar Energy Corporation, a Texas Corporation, Business Exchange Investments, Inc., Cause Number 07-15951-CV, pending in the District Court, 13th Judicial District, Navarro County, Texas (hereinafter "State Court Litigation"). The state court suit seeks to terminate an oil and gas lease and seeks legal fees against the Debtors and other defendants.

On May 16, 2011, the Bankruptcy Court granted relief from the automatic stay to allow the Creditors to pursue the State Court Litigation as of June 16, 2011, provided that the plaintiffs may only assert in the litigation vis a vis Reostar Energy the claims asserted in the timely filed Proofs of Claim, assigned Claim Nos. 14 - 17. The Bankruptcy Court found that the modification of the stay is limited to the plaintiffs and that no cross claims or other claims could be filed by any of the other defendants.

Debtors have filed an Objection to the Claim Nos. 14 -17 **[Docket No. 154]** on the grounds that they are duplicative and represent multiple recoveries against the estate. The Debtors have also requested that these Claims be estimated for confirmation.

*c. Proposed settlement with Rife Energy Operating, Inc.*

By way of background, Rife Energy Operating Co. ("Rife Energy") engages in the /development of oil and natural gas and is 100% owned by M.O. Rife, II, who is also the Debtors' Chief Executive Officer and a member of the Board of Directors, as well as a shareholder of the Debtors. Mr. Rife formed Rife Energy in 2002. Rife Energy is headquartered in Fort Worth, Texas where a staff of six provides accounting, administrative and management services. Rife Energy also has a field office in Rosston, Texas that has four fulltime employees who run operations.

It is contemplated under the Plan, that Mr. Rife shall hold interests in the Reorganized Debtors, and shall sell Rife Energy to the Reorganized Debtors under a secured promissory note for the purchase price of $3.2 million.

ReoStar Energy's Schedules filed in the Bankruptcy Case identify an obligation owing to Rife Energy in the amount of $860,003.73 and to Texas MOR in the amount of $133,828.89 (the "ReoStar Energy Payable"). ReoStar Operation's Schedules filed in its bankruptcy case identify an obligation owing to Rife Energy in the amount of $6,178.62 and to Texas MOR in the amount of $166,093.63 (the "ReoStar Operating Payable"). The total of the ReoStar Energy Payable and the ReoStar Operating Payable is $1,166,104.87 (this amount is referred to herein as the "ReoStar Payable").

ReoStar Energy's Schedules filed in the Bankruptcy Case show the amount of $1,289,188.68 as owing by Rife Energy to ReoStar Energy and the amount of $270,610.38 as owing to ReoStar Energy by Texas MOR, for a total due of $1,559,799.06 (the "ReoStar Energy Receivable").

Rife Energy filed a Proof of Claim, assigned Claim No. 11 in the Bankruptcy Cases against ReoStar Energy and ReoStar Gathering in the amount of $1,215,192.90. Rife Energy filed a Proof of Claim, assigned Claim No. 3 in the Bankruptcy Cases against ReoStar Operating in the amount of $6,178.62. Rife Energy filed a Proof of Claim, assigned Claim No. 2 in the Bankruptcy Cases against ReoStar Leasing in the amount of $2,250.50.

MorOil, Inc. ("MorOil") filed a Proof of Claim, assigned Claim No. 12, in the Bankruptcy Cases against ReoStar Energy and ReoStar Gather in the amount of $211,053.70.

Texas M.O.R., Inc. ("Texas MOR") filed a Proof of Claim, assigned Claim No. 5 in the Bankruptcy Cases against ReoStar Operating in the amount of $401,663.86.

The total amount of the five proofs of claim identified in the three foregoing paragraphs is $1,836,339.58.

The Parties met to discuss the foregoing, and exchanged a significant amount of information relating to the claims they have against each other in an effort to reach an understanding as to the responsibility to each other regarding the claims. There were significant disputes between the parties with respect to the claims. In order to save the parties from incurring significant fees and expense to litigate the claims between them, the parties, subject to this Court's approval, reached an agreement to resolve the disputes which exist or might exist by and among them relating to their respective claims. The parties reduced their agreement to writing in the form of a Settlement and Release Agreement (the "Rife Agreement"). Debtors have asked the Court to approve the Rife Agreement. [See Doc. No. 159]. BT & MK has filed an objection the Rife Agreement. A hearing initially was set to consider the Rife Agreement on November 9, 2011; however, such hearing has been passed. As part of the Plan, the Debtors shall assign prosecution and settlement of the Rife Agreement to the Creditor Trust. The parties believe that the Rife Agreement resolves all claims between the parties as they relate to the parties and their affiliated entities, persons and assigns, as set forth therein, and that it will be approved by the Court, subject to the Creditor Trustee's sole discretion. Under the Rife Agreement, as is anticipated to be modified after transfer to the Creditor Trust, if approved, the non-debtor claimants will withdraw their claims against Debtors' estates and the Creditor Trust will receive payment of the sum of $46,419.61.

*d.* *Nitro Claim*

On March 10, 2011, Nitro Petroleum, Inc. filed a Proof of Claim, assigned Claim No. 13 for $1,551,459.00 claiming it to be partially secured. The claim was signed by counsel for the claimant and ReoStar Energy wholly disputed the claim. An objection was filed on March 28, 2011 [Dockets No. 134 and 135] after which the court entered an order on April 20, 2011 [Docket no. 144] withdrawing Claim No 13 in its entirety with the agreement of the Creditor.

*3. Sale of Ford Well Assets*

Upon filing the Bankruptcy Cases, ReoStar Energy owned and/or scheduled certain assets and interests in the Barnett Shale region of Texas, including the following: interests in and to oil and gas leases (the "Leases") and the Ford #1 (API 42-097-33896) (the "Ford Well") in Cooke County, Texas (the Leases and the Ford Well collectively being referred to herein as the "Ford Well Assets"). During the pendency of the Cases, Debtors, specifically ReoStar Energy, received an offer from EOG Resources, Inc. ("EOG") to acquire these assets. ReoStar

Energy accepted the offer subject to approval by the Bankruptcy Court. The sale of the Ford Well Assets to EOG, free and clear of all liens, interests, and/or encumbrances was approved by the Bankruptcy Court on April 14, 2011. Following approval of the sale, ReoStar learned that EOG fraced into the well and caused loss of oil, as well as environmental and other damages. In addition to the sales price approved by the Court, EOG agreed to pay ReoStar an additional amount of money as a result of the fracing incident. The sale of the Ford Well Assets to EOG closed on May 4, 2011. The proceeds from the sale, $201,155.00, were place by ReoStar in a segregated account pending direction by the Court as to their disposition. The Court entered an Order on July 25, 2011 regarding the distribution of the proceeds. [Doc. No, 235].

*4. Burlington Top Lease Dispute*

Burlington Resources Oil and Gas Company, LP is an oil and gas company and claims to have a leasehold in certain oil and gas interests on 710 acres in Cooke County, Texas (the "<u>Burlington Lease</u>"). Burlington is a party-in-interest in this bankruptcy case due to its interest in the Burlington Lease and on October 11, 2011 filed Adversary Proceeding No. 11-04184, styled Burlington Resources Oil and Gas Company, LP v. Reostar Energy Corporation and BT and MK Energy and Commodities, LLC, seeking, among other things, declaratory relief including declarations that: 1) the Top Lease is void and/or invalid; 2) alternatively, that the Top Lease expired; and 3) that there is no lien or other secured interest encumbering the Top Lease (the "Burlington Adversary").

In the Burlington Adversary, Burlington alleges as follows:

> The Debtor, ReoStar Energy, has scheduled the same 710 acres that are alleged to be covered by the Burlington Lease in its Schedules as the "Hancock" lease. (Doc. 40, Schedule A-1); that ReoStar Energy's lease is dated September 1, 2007, and entered between the Hancock Family Limited Partnership, as lessor, and Ed Harris, as lessee ("<u>Top Lease</u>"), and that the Top Lease is recorded in Volume 1574, Page 106, of the Official Public Records of Cooke County, Texas.
>
> On June 16, 2008, Ed Harris executed an Assignment of Oil and Gas Lease and an amendment thereto purporting to convey to ReoStar a one hundred percent (100%) working interest and seventy-seven percent (77%) net revenue interest in the Top Lease.
>
> However, Burlington alleges the Top Lease is invalid and void as a matter of law; and further alleges that in addition to the Top Lease, various unrelated entities have an interest in a lease dated October 1, 2003, which includes the 710 acres covered by the Top Lease ("<u>Bottom Lease</u>"). The Top Lease contains a provision stipulating that the Top Lease "is dated September 1, 2007 but is effective and has a primary term beginning on the filing date of the release to the Bottom Lease. Burlington alleges that this language creates a springing executory interest that can only vest if and when the Bottom Lease is released. The Bottom Lease could be released at any time or not at all. Under such circumstances, the Top Lease is void as a matter of law for violating the Rule Against Perpetuities, citing Peveto v. Starkey, 645 S.W.2d 770 (Tex. 1982).
>
> Burlington also asserts there has been no production on the Top Lease since October 23, 2007, and that the portion of the Bottom Lease including the 710 acres in the Top Lease was also released as of October 23, 2007; and, therefore, the Top Lease expired under its own terms and is not part of the Debtors' bankruptcy estate.

<u>Burlington and the Debtors expect the validity of the Top Lease will be determined in connection with the Burlington Adversary Proceeding, and each party fully reserves its rights to have the ownership of the Top Lease acreage determined. This dispute has a minimal affect, if any, on the profit projections and liquidation analysis, as these acres are currently not producing income. However, the Debtors' projections do include the Top Lease acreage, and therefore, could change based on the outcome of the Burlington Adversary.</u>

*5. Inglish Family,Lease Dispute*

A dispute arose with regard to certain leases between the Debtors and Elizabeth Kay Inglish Aldridge, individually and as Independent Co-Executrix of the Estate of William Bailey (W.B.) Inglish, Deceased, Ann Inglish Knight, individually and as the Independent Co-Executrix of the Estate of William Bailey (W.B.) Inglish, Deceased, and Norma Ann Inglish Knight, individually (collectively referred to herein as the "Inglish Family") with regard to what acreage remains subject to the Inglish Leases. On August 15, 2011, the Debtors, through counsel, provided the Inglish Family, through its counsel, with a schedule of the Inglish Wells (All Leases) which lists each well, together with its API Number, spud date, date of first production, RRC Permit Number, type of well (oil or gas), and RRC ID Number (including ID Number as reclassified, if applicable). Certain inadvertent errors on the Debtors' Schedules did not match the actual acearage shown on the Debtors' books and records, and the Debtors' believe these errors on the Schedules, which have now been rectified, and were shown correctly on the schedule provided on August 15, 2011, caused this dispute to arise.

With respect to the Inglish B Lease, three wells (the Inglish B Nos. 1, 2 and 3 Wells) were drilled and all three continue to produce oil and/or gas. These three wells were originally completed as oil wells, and the B Lease was given Railroad Commission ("RRC") ID No. 30816. All Lease B production was reported under that RRC ID No. until October 2008, when the three wells were reclassified as gas wells and given RRC ID Nos. 248923, 248924 and 248926, respectively. Beginning October 2008, all production from these wells has been reported under the gas well ID Nos. A schedule for each of these wells setting forth the production history beginning with their reclassification in October 2008 was provided to counsel for the Inglish Family on August 15, 2011. The Debtors suspect that reclassification of these wells and the resulting change in RRC ID Nos. created the confusion that resulted in the Inglish Family's claim that none of these wells have produced any product for at least a year according to information obtained from the Texas Railroad Commission.

The primary term of the Inglish B Lease, as extended by drilling operations, has now expired; and under the terms of Paragraphs 16 and 17 of the Lease, each well continues to hold 40 acres. Whether the B Lease covers 132.24 acres as described in the Lease or 145.5 acres as resurveyed, the Inglish B No. 1, 2 and 3 Wells continue to hold 120 acres. The Debtors' have made a proposal to the Inglish Family for the release of certain of its interests in connection with the Inglish B Lease, as well as providing other clarifying information as set forth herein, and have made efforts to correct their Schedules, all to resolve the disputes regarding these Leases.

With respect to the Inglish Lease, the Lessees have drilled and continue to produce oil and/or gas from 16 wells (the Inglish Nos. 1, 2, 3, 4, 5, 6, 7, 8, 9, 10, 11, 12, 13, 15, 16 and 1H Wells). Under paragraph 17 of the Inglish Lease the drilling of each well extends the original 3 year primary term an additional one year. Therefore, the 16 wells drilled have extended the primary term to a total of 19 years; and in the absence of additional drilling, the primary term would expire in 2022. Inasmuch as the Inglish Lease remains within its extended primary term, no acreage covered by that Lease has expired. Like the Inglish B Lease, the Inglish Lease also provides that at the expiration of the extended primary term, each producing well holds 40 acres; and looking ahead, a minimum of 9 producing wells would hold the 359 acres described in the Lease and a minimum of 10 producing wells would hold the 378.5 acres reflected by the resurvey. The fact that the Inglish No. 14 Well has not been drilled to date and appears to be of no import to the Inglish Family dispute.

With respect to the Inglish D Lease, the Lessees have drilled and continue to produce oil and/or gas from 14 wells (the Inglish D Nos. 1, 2, 3, 4, 5, 6, 7, 8, 9, 10, 11, 12, 15 and 17). Under paragraph 17 of the Inglish D Lease the drilling of each well extends the original 3 year primary term an additional one year; and the 14 wells drilled have extended the primary term to a total of 17 years. In the absence of additional drilling, the primary term would expire in 2020. Inasmuch as the Inglish D Lease remains within its extended primary term, no acreage covered by that Lease has expired. Again, this Lease also provides that at the expiration of the extended primary term, each producing well holds 40 acres; and looking ahead, a minimum of 21 producing wells would hold all of the 814 acres described in the Lease.

With respect to the Inglish Sisters Lease, the Lessees have drilled and continue to produce oil and/or gas from 9 wells (the Inglish Sisters Nos. 1, 2, 3, 4, 5, 6, 7, 8 and 9). Under paragraph 17 of the Inglish Sisters Lease the drilling of each well extends the original 3 year primary term an additional one year; and the 9 wells drilled have extended the primary term to a total of 12 years. In the absence of additional drilling, the primary term would expire in 2015. Inasmuch as the Inglish Sisters Lease remains within its extended primary term, no acreage covered by that Lease has expired. Again, this Lease provides that at the expiration of the extended primary term, each producing well holds 40 acres; and looking ahead, a minimum of 7 producing wells would hold all of the 247.5 acres described in the Lease.

The Debtors are continuing to attempt to resolve any remaining confusion or disputes surrounding the Inglish Family Leases.

On September 30, 2011, Elizabeth Kay Inglish Aldridge as Independent Co-Executrix of the Estate of William Bailey (W.B.) Inglish, Deceased, and Norma Ann Inglish Knight, individually and as the Independent Co-Executrix of the Estate of William Bailey (W.B.) Inglish, Deceased (collectively, the "Inglish Family"), filed *The Inglish Family's Motion For Relief From Automatic Stay as to State Court Litigation* (Dkt. No. 300) (the "Motion"). The Inglish Family seeks to have the automatic stay in bankruptcy modified to permit them to proceed with state court litigation, which has yet to be filed, to obtain a declaration that ReoStar Energy does not have any equity in certain currently undeveloped and non-producing acreage which is the subject of certain oil and gas leases which have been identified in ReoStar Energy's Schedules A and G, as amended, as the Inglish D Lease and the Inglish Sisters Lease, as well as other state law damage claims. ReoStar Energy disputes these contentions and will contest the Motion.

K. Marketing Efforts in Chapter 11

ReoStar has worked with several potential buyers for its leasehold and production assets in the Barnett Oil Window and Corsicana.

Detailed due diligence, including extensive field inspection, was performed on the Barnett properties by two qualified potential buyers who have substantial leasehold positions and production offsetting ReoStar's acreage position. The Debtors cannot disclose the names of these potentially interested buyers.

One of these companies made a cash offer for ReoStar's position but put conditions on the offer that ReoStar has no control over:

1) Must acquire 100% of the Working Interest in the existing wells.

2) Must have operations.

3) Must have the gas contract re-written with the gas purchaser.

The other company declined to make an offer because of 2011 budget restraints.

A third company that does not have a position in the Barnett, had made a cash offer of $10 million but that offer expired February 28, 2011. This offer was made prior to ReoStar's Chapter 11 filing. ReoStar has not been successful in securing a new offer from this, or any other company to sell the Debtors' Assets.

ReoStar has had numerous discussions with potential purchasers of the Corsicana assets. Four qualified companies have submitted conditional offers ranging from $1 million up to $1.300 million. These offers include acquiring all of the leasehold and operational equipment that is utilized in the ongoing operations of this asset. A considerable amount of the operational equipment is not owned by ReoStar. This equipment will be titled to ReoStar under the compromise Agreement, described above, between ReoStar and Rife Energy Operating and its affiliates. All of the offers are conditional upon satisfactory title examination.

The fact that all offers for ReoStar's assets had conditional components that were either out of ReoStar's control (as described above) or cost prohibitive (i.e. Title Opinions) in nature makes the sale of these assets very difficult at this time. The proposed Plan with Russco, which will provide equity and new financing for ReoStar, will allow ReoStar to buy out other Working Interest owners in the existing Barnett wells. Russco has also structured a proposed acquisition of Rife Energy Operating that would allow the Reorganized ReoStar to control operations of all its wells and leasehold going forward. This will vastly improve the ability of ReoStar to sell its Assets in the future, and significantly increases the value of the Reorganized Debtors. The acquisition of Rife Energy Operating by the Reorganized Debtors will not result in the substantive consolidation of Rife Energy Operating with the

Reorganized Debtors. The acquisition of Rife Energy Operating by the Reorganized Debtors will not result in the creditors of Rife Energy Operating being subject to the Reorganized Debtors' Plan or Confirmation Order; instead, the creditors of Rife shall continue to be paid in the ordinary course of business and shall not be subject to the distribution percentages set forth in the Reorganized Debtors' Plan, which only pertain to the Allowed Claims of the Reorganized Debtors' Creditors as described and defined therein. Rife's creditors are not subject to the discharge, injunction, or release provisions in the Reorganized Debtors' Plan or Confirmation Order, unless such creditor is asserting a Claim against the Reorganized Debtor.

L. Description of Current Assets

ReoStar's current assets consist of:

a. Approximately 9,000 gross acres of mineral resources – 5,000 acres in the "Oil Window" of the Barnett Shale and 4,000 acres in the Corsicana, Texas area.

b. As producing properties, the March 31, 2011 Forrest A. Garb & Associates, Inc. reserve report[12] estimates ReoStar's future proved producing net revenues discounted at 5% to be $6,200,000; including Barnett Shale assets - $5,200,000 & Corsicana shallow wells - $1,000,000. This revenue would be derived from 69 non-operated wells in Cooke, Montague, and Wise Counties, Texas in the Barnett Shale and producing operated wells in Corsicana, Texas.

c. As proved undeveloped properties, the Debtors hold between 3,700 and 2,900 acres in the Barnett Shale that are believed to be worth $1,300 per acre.

d. Equipment – ReoStar's primary equipment assets include a workover rig, swab rig, shallow drilling rig, and reverse-osmosis units that are believed to have a market value of approximately $1,000,000.

e. Property – ReoStar owns a 10-acre yard on which their 2,500 square foot office building sits in Corsicana, Texas, which is believed to be worth approximately $300,000.

f. Cash, Accounts Receiveable and Other Assets – The Debtors' aggregate cash, accounts receivable, inventory and other assets are currently valued in excess of $2,000,000.

The Debtors' respective Schedules B's, as may have been amended, reflect the Debtors' best estimates of assets and values as of the Petition Date. The Debtors' Monthly Operating Reports reflect the Debtors' current assets and values.

M. Background of the Debtors' Management

Effective October 5, 2010, Mark Zouvas and Scott Allen each resigned from the Board of Directors of ReoStar Energy Corporation. Effective November 15, 2010, Mark Zouvas resigned from ReoStar Energy Corporation as its Chief Executive Officer.

Effective November 15, 2010, M.O. Rife III was appointed as the Chief Executive Officer of ReoStar Energy Corporation (the "Company"). Mr. Rife, age 71, is the current Chairman of the Board of Directors of the Company, a position he has held since February 2007. Mr. Rife also serves on the Company's Audit Committee as

[12] The reserve report was prepared using: (i) oil at $83.63 per barrel; (ii) gas at $4.13 per MMBtu; (iii) NGLs at $0.87 per US gallon ($36.54 per barrel) of 43.7% of the oil price; and (iv) regional and lease differential price adjustments (deducts and/or additions) were calculated using ReoStar's revenue settlement statements. Differential adjustments were applied on a lease specific basis. These prices above were calculated using SEC and FASB compliant rules specifying at simple arithmetic average of the price posted on the first trading day of the preceding 12 months. On October 12, 2011, West Texas Intermediate posted at $85.30 per barrel of oil and Henry Hub gas at $3.54 per MMBtu. Oil prices have recovered somewhat from the lows at the end of September and can be viewed at: http://www.eia.gov/oog/info/ngw/ngupdate.asp.

its chairman and as a member of its Compensation Committee. From August 2003 to February 2007, Mr. Rife was a partner of REO Energy, Ltd, a predecessor company to ReoStar Energy. From November 2003 to February 2007, Mr. Rife was a partner of JMT Resources Ltd, a predecessor company to ReoStar Energy. From 1997 to 2005, Mr. Rife served as Chairman of Board of Matrix Energy Services Corp., a publicly traded oil and gas exploration company. Mr. Rife has been in the oil and gas industry for 50 years and has been involved in the drilling, completion and operation of over 3,500 wells throughout the mid-continent Region including Louisiana, Oklahoma, and New Mexico. Mr. Rife attended Texas Christian University. There is no family relationship between Mr. Rife and any of the other executive officers or directors of the Company.

N. Debtors' Termination of Registration

On June 1, 2011, the Debtors' Board of Directors unanimously voted to terminate the registration of the Debtors' common stock under the Securities and Exchange Act of 1934 and to suspend the Debtors' obligations to file reports under Section 15(d) of the Exchange Act. The Debtors were eligible to deregister by filing a Form 15 because the Debtors had fewer than 300 holders of record of its common stock. On June 16, 2011 the Debtors' filed Form 15 providing certification and notice of termination of registration under section 12(g) of the Securities Exchange Act of 1934 or suspension of duty to file reports under sections 13 and 15(d) of the Securities Exchange Act of 1934. The Debtors' deregistration is now complete.

O. Goal of the Debtors' Bankruptcy Case

The Debtors' Bankruptcy Case is intended to allow the Debtors, among other things, the opportunity for: (i) breathing room from the BT & MK foreclosure and an ability to address the BT & MK Claims through the BT & MK Adversary Proceeding; (ii) addressing potential litigation against BT & MK and related Receivership Parties, Mark Zouvas, Ray Lee and others against whom the Debtors have causes of action, including the auditors on the company's transaction going private to public, Killman, Murrell & Co., P.C. out of Odessa, Texas; Peter Zouvas; Three Bar C, Inc., and others; (iii) maximizing the value and revenue stream from the Debtors' ability to develop and increase oil and gas reserves and production through internally generated drilling projects, coupled with complementary acquisitions including operators of producing oil and gas mineral-interest portfolios by recapitalizing the company and raising private equity; and (vi) reorganizing the Debtors' obligations to enable them to continue their existing business, pursue drilling opportunities, and new business and growth opportunities.

## V. POST-PETITION OPERATIONS

Since the Debtors filed their voluntary petitions, the Debtors have continued to operate in the normal course of business. The Debtors have filed their schedules and statements of financial affairs with the Court (including all amendments and supplements thereto, the "Schedules"). The Schedules contain a detail of the Debtors' assets, liabilities, and other information related to the business activities. Copies of the Debtors' Schedules and other filings may be obtained online from the Court's website at: http://www.txnb.uscourts.gov/pacer/. For information or to subscribe to PACER (the online court-document-viewing system), you may visit the PACER Service Center website at http://www.pacer.gov. Due to the payment of certain creditors, certain court-approved agreements, and the discovery and/or investigation of other assets and liabilities, the Debtors' Schedules may be subsequently amended from time to time to reflect such information; however, any failure to amend shall not result in a claimant's Claim receiving a distribution for amounts already satisfied, released, or assigned.

Also, in conformance with the Guidelines of the Office of the United States Trustee for the Northern District of Texas, the Debtors have filed the required monthly operating reports and paid the quarterly United States Trustee fees. The monthly operating reports detail the Debtors' post-petition operating activities, income, and disbursements. Copies of the Debtors' monthly operating reports also may be obtained online from the Court's website at: http://www.txnb.uscourts.gov/pacer/.

Also, in conformance with requirements of the United States Securities and Exchange Commission (the "SEC"), the Debtors' filed their 10-Q Form Report on February 18, 2011, which contains significant information concerning the Debtors' post-petition operations, as well as Form 8-K's. These reports can be found by going to the following website and enter the name "REOSTAR" into the field labeled "Company name:"

http://www.sec.gov/edgar/searchedgar/companysearch.html.

## VI. ASSETS AND LIABILITIES OF THE DEBTORS

### A. Overview of the Debtors' Assets and Liabilities

The Debtors have expended considerable time and effort to ensure the accuracy of the estimated information on the Plan Projections, the Claims Payment Schedule and the Sources and Uses of Capital Funding, attached as Exhibit "B," however, no representation can be made that such information is without some level of inaccuracy. Moreover, the information set forth thereon is subject to the uncertainties of litigation and other factors that may not be resolved in the Debtors' favor. Therefore, no assurance can be given that the estimated Allowed Claims are exact or that the estimated recoveries will be achieved.

### B. Claims Asserted Against the Debtors

The Claims filed against the Debtors exceed **$15 million**, including additional scheduled Claims by the Debtors for which a proof of Claim was not filed. The Claims filed against the Debtors have not necessarily become Allowed Claims. The Debtors are in the process of analyzing these Claims and may file objections to one or more of such Claims. The Plan allows the Debtors and Reorganized Debtors until the Effective Date to file objections to Claims. The Plan further provides that the filing, litigation, settlement, or withdrawal of all objections and Estate Actions may be made by the Reorganized Debtors without approval by the Court under Bankruptcy Rule 9019. The Court's register for Claims filed against the Debtors is available on the Courts' website at: http://www.txnb.uscourts.gov/pacer/. The Debtors' Claim registers contain some Claims that have been paid, resolved in lower amounts, are duplicative, or are disputed by the Debtors.

### C. Estimated Allowed Claims and Estimated Recoveries

The Debtors reserve all rights to object to any and all Claims, liens, and Interests filed or asserted against the Debtors or their property or property interests notwithstanding any discussion or treatment herein. The Debtors estimate that the aggregate Allowed Claims against the Debtors' estates will be as set forth in the estimated Claims Payments Schedule, included as part of the Plan Projections attached as Exhibit B, and as set forth below:

| Class | Est. Claim Amt. | Est. Pay. Amt. | Payment Sched. |
|---|---|---|---|
| Class 2.2 - Allowed secured claim of BT & MK | Unknown (Adversary Pending) | Unknown (Adversary Pending) | Amount of Allowed Secured Claim; paid in full over 10 years amortized at 5% |
| Class 3.1 - Allowed priority unsecured claims of ReoStar Energy | $2,800 | $2,800 | $2,800 at Effective Date |
| Class 3.2 - Allowed priority unsecured claims of ReoStar Operating | $25,400 | $25,400 | $25,400 at Effective Date |
| Class 4.1 - Allowed unsecured claims of ReoStar Energy | $3,500,000 | $700,000 | $19,444 / mo. for 36 mo. beginning on the Effective Date |
| Class 4.2 - Allowed unsecured claims of ReoStar Operating | $41,000 | $8,200 | $228 / mo. for 36 mo. beginning on the Effective Date |
| Class 4.3 - Allowed unsecured claim of BT & MK | Unknown (Adversary Pending) | Unknown (Adversary Pending) | 20 % paid over 36 mo., if Allowed |

D. Estimated Professional Fees and Reorganization Costs

The Debtors estimate that aggregate requested postpetition professional fees and other reorganization costs asserted in their Bankruptcy Cases, excluding ordinary course liabilities, will be approximately $750,000 on the Effective Date, assuming an Effective Date in January 2012. The estimated requested Administrative Expenses will be as follows:

| Administrative Claims (all subject to Court approval) | **Total** | **Amt. Unpaid (incl. un-accrued)** |
|---|---|---|
| Cantey Hanger LLP | $600,000 | $800,000 |
| Miscellaneous Administrative Claims | $150,000 | $200,000 |
| Totals | **$750,000** | **$1,000,000** |

The Allowed Administrative Claim of E-Fire, Ltd., as set forth in the (a) *Motion to Approve Post-Petition Loan by Insider, Nunc Pro Tunc*,and (b) *First Amended Motion to Approve Post-Petition Loan by Insider, Nunc Pro Tunc* [Docket No. 137] (the "E-Fire Motions"), shall be paid in accordance with the *Order Granting (A) Debtors' Motion to Approve Post-Petition Unsecured Loan by Insider, Nunc Pro Tunc and (B) First Amended Debtors' Motion to Approve Post-Petition Loan by Insider, Nunc Pro Tunc* [Docket No. 143], which provides that the post-petition financing by E-Fire, Ltd. as set forth in the E-Fire Motions shall be an administrative expense to be paid only after all other administrative expenses in the cases have been paid in full.

E. Preference and Other Avoidance Litigation and Estate Actions

Pursuant to the Bankruptcy Code, Debtors may recover certain preferential transfers of property, including Cash, made while insolvent during the ninety (90) days immediately prior to the filing of its bankruptcy petition with respect to pre-existing debts, to the extent the transferee received more than it would have in respect of the pre-existing debt had the Debtors been liquidated under Chapter 7 of the Bankruptcy Code. In the case of Insiders, the Bankruptcy Code provides for a one-year preference period. There are certain defenses to such recoveries. Transfers made in the ordinary course of the Debtors' and the transferee's businesses, according to ordinary business terms, are not recoverable. Furthermore, if the transferee extended credit subsequent to the transfer (and prior to the commencement of the bankruptcy case), such extension may constitute a defense, to the extent of any new value, against any otherwise recoverable transfer of property. If a transfer is recovered by Debtors, the transferee has a General Unsecured Claim against the Debtors to the extent of the recovery. The Debtors reserve all rights to assign, at their sole discretion, and subject to their Business Judgment, any Estate Actions not limited to but including any preference to the full extent allowed under the Bankruptcy Code and applicable state laws to the Creditor Trust. The Debtors may also assign other actions including but not limited to actions under sections 542, 543 and 549 of the Bankruptcy Code. Potential avoidance actions and other causes of action are set forth on the Debtors' Schedules B and Statements of Financial Affairs at question no. 3, which Schedules and Statements of Financial Affairs are incorporated herein by this reference, and which are presented for prosecution by the Creditor Trustee under the Plan.

Also, under the Bankruptcy Code and various state laws, Debtors may recover certain transfers of property, including the grant of a security interest in property, made while insolvent or which rendered them insolvent if, and to the extent, the Debtors receive less than fair value for such property. The Debtors reserve all rights to assign, at their sole discretion, and subject to their Business Judgment, any fraud or fraudulent transfer Estate Actions to the full extent allowed under the Bankruptcy Code and applicable state laws.

Without limitation of any claims and causes of action referenced and described in the Schedules, the Estate Actions include various potential avoidable transfers that can be recovered under Chapter 5, including transfers within four years prior to the Petition Date that can be recovered under section 544.

Additionally, prior to and since the filing of the Bankruptcy Cases, and as described in the Schedules and this Disclosure Statement with respect to prepetition claims and events, acts of third parties may have given rise to Estate Actions including but not limited to claims for recharacterization, equitable subordination, certain breach of contract and tortuous interference with contract actions, breaches of fiduciary duty, negligence and gross negligence claims, conspiracy and aiding and abetting claims, claims for knowing participation in breaches of fiduciary duty, claims for usury and violation of the automatic stay, claims against prepetition professionals, claims against pre-petition or post-petition officers of the Debtors and claims for lost profits, damages, and attorneys fees. By way of example, and not of limitation, these claims exist against BT & MK and related Receivership Parties, Mark Zouvas, Ray Lee and others, including Peter Zouvas; Three Bar C, Inc., and others named in the BT & MK Adversary, which is incorporated herein by reference as if set forth verbatim and can be found at Adv. Doc. No. 44-1 within Adv. Proc. No. 11-04022. As a condition to confirmation of the Plan, the Court directs the Examiner, pursuant to the Plan and Confirmation Order, and to achieve the maximum value for the estates, to assign the BT & MK Adversary to the Creditor Trust, as his final ministerial act in these Bankruptcy Cases.

Killman Murrell & Co., P.C.

In connection with its efforts to go from a privately held to publicly held company, Debtors engaged and utilized the professional accounting services of Killman Murrell & Co., P.C. ("KMC"). KMC conducted an audit of Debtors' books and records in connection with the formation of the public entity and the transfer of assets from certain entities into ReoStar. Debtors have requested certain accounting books and records be produced by KMC relating to the transition from a privately held to publicly held entity. Debtors may have causes of action against KMC relating to the audit and certain errors and/or omissions pertaining thereto and, therefore, reserve all rights to bring causes of action relating to such errors and/or omissions which may be discovered.

The Debtors reserve all rights to assign, in their sole discretion, any such claims to the full extent allowed under the Bankruptcy Code and applicable state laws to the Creditor Trust.

## VII. OVERVIEW OF THE PLAN

### A. Introduction

THE PLAN ANNEXED HERETO AS EXHIBIT "A" IS AN INTEGRAL PART OF THIS DISCLOSURE STATEMENT. THE OVERVIEW OF THE PLAN SET FORTH HEREIN IS QUALIFIED IN ITS ENTIRETY BY REFERENCE TO THE FULL TEXT OF THE PLAN. IN THE EVENT OF AN INCONSISTENCY BETWEEN THE PROVISIONS OF THE PLAN AND THE OVERVIEW CONTAINED HEREIN, THE TERMS OF THE PLAN SHALL GOVERN.

Generally, the Plan is a Chapter 11 plan of reorganization that vests the assets of the Debtors' estates in the Reorganized Debtors. The Reorganized Debtors will be directed to make distributions and payments required by the Plan, object to Claims against the Debtors' estates, and prosecute claims and Estate Actions against third parties as appropriate. The Creditor Trustee under the Creditor Trust, established under the Plan, will be directed to make distributions to Allowed Class 4 General Unsecured Creditors under the Plan.

On the Effective Date, all real and personal property of the Debtors' estates, including but not limited to all Estate Actions not otherwise assigned by the Debtors or Examiner to the Creditor Trust, shall vest in the Reorganized Debtors; *provided that* upon any subsequent conversion to a case under Chapter 7, all assets vesting in the Reorganized Debtors shall pass to the Chapter 7 trustee as property of the Chapter 7 estate subject to those Claims, liens, and encumbrances as allowed and restructured in the Plan and as specified therein. All Claims assigned to the Creditor Trust shall be in conformance herewith and disclosed in the solicitation package to be approved at the hearing on approval of the Disclosure Statement. From and after the Effective Date, the Reorganized Debtors shall be authorized to operate in the ordinary course of business, and shall be authorized to make the distributions required under, and implement the provisions of, the Plan.

B. Information on Equity Bidders

(1) Russco Energy LLC

The Plan Proponent, Russco, is a Texas Limited Liability Company. Russco was formed on June 24, 2011. Russco's two managers consist of R. Kevin Russell and Benton J. Poole.

Mr. Russell has over thirty-five (35) years of significant experience in all aspects of the oil and gas industry. Mr. Russell currently owns and is the managing member and director of Toledo Gas Gathering LLC ("Toledo"), which was formed on October 18, 1999 and operates at 515 North Fredonia Street, Longview, Texas 75601. James K. Russell is a member of Toledo and Raymond S. Russell is the treasurer of Toledo.

Mr. Poole, in turn, is an attorney duly licensed by the State Bar of Texas, who for over thirty-five (35) years has practiced almost exclusively in the area of oil and gas law. Mr. Poole has his own law firm named Benton J. Poole, PC located at 1232 Manchester Drive, Rockwall, Texas 75032. The law firm was formed on August 25, 1997.

Mr. Russell and Mr. Poole were both managers of Eastman Gas Company, LLC (formerly Fairplay Gas Company LLC) ("Eastman"). Eastman is the general partner of FairPlay Midstream LP (formerly Fairplay Gas Gathering LP) ("FairPlay"). FairPlay started with $5 million dollars in capital. Mr. Russell and Mr. Poole obtained equity and $35 million in financing facility with Macquire Bank. FairPlay was sold in 2007 for $155 million when it had grown to 160 miles of pipeline and associated processing facilities.

Eastman also is the general partner for Eastman Midstream, LP. ("Midstream") Mr. Russell and Mr. Poole capitalized Midstream with $6 million in equity and $ 6 million in debt. Midstream's EBITDA is $3 million.

Mr. Russell also manages working interests in over 5000 acres in East Texas Haynesville/Cotton Vally with six (6) producing wells. Mr. Russell also drilled and operated over 200 wells in the Willow Springs Production, Inc. and Toledo.

(2) Rife/Bennett Group

The Rife/Bennett group consists of M.O.R. Holdings, LLC (managed by M.O. Rife, III) and JBB Holdings, LTD. The limited partners in JBB Holding, LTD include Jon B. Bennett (33%), James B. Bennett (33%) and Jana B. Bennett (33%). JBB GP, LLC is the General Partner with a percentage interest of 1%. The general partnership is 100% owned by Jon B. Bennett.

Other than the disclosures made herein in this Disclosure Statement, no known relationships between and among the Debtors, Russco and the Rife/Bennett Group existed prior to and subsequent to the chapter 11 filing. Rife Oil Properties, Inc. filed chapter 11 Bankruptcy in 2002. See Case No. 02-42745. At the time of the bankruptcy filing, Trey Rife was President and sole shareholder. Ultimately, Rife Oil Properties, Inc. was liquidated with unsecured creditors receiving no distributions on their claims. Any and all financial information about Rife Oil Properties can be obtained online from the Court's website at: http://www.txnb.uscourts.gov/pacer/. For information or to subscribe to PACER (the online court-document-viewing system), you may visit the PACER Service Center website at http://www.pacer.gov.

C. Classification of Claims and Interests

*1. Classification*

Pursuant to section 1122 of the Bankruptcy Code, except as otherwise provided herein, all Claims (except for Administrative Claims and Priority Tax Claims) and all Interests shall be classified as set forth in Article 3 of the Plan. The classification of Claims and Interests in Article 3 of the Plan gives effect to the priority scheme generally adopted by the Bankruptcy Code. In accordance with section 1123(a)(1) of the Bankruptcy Code, Administrative Claims, and Priority Tax Claims are not classified under the Plan, and the treatment of those Claims is set forth in Article 2 of the Plan.

2. *Claims and Interests.*

The Plan classifies the Claims against the Debtors and Interests in the Debtors as follows:

| | |
|---|---|
| Class 1: | Secured Tax Claims. |
| Class 2.1: | Secured Non-Tax Claims of M&M Lienholders. |
| Class 2.2: | Secured Non-Tax Claims of BT & MK. |
| Class 3.1: | Priority Unsecured Claims of ReoStar Energy. |
| Class 3.2: | Priority Unsecured Claims of ReoStar Operating. |
| Class 4.1: | General Unsecured Claims of ReoStar Energy. |
| Class 4.2: | General Unsecured Claims of ReoStar Operating. |
| Class 4.3: | General Unsecured Claim of BT & MK. |
| Class 5: | Subordinated and Penalty Claims. |
| Class 6: | Interests. |
| Class 7: | Subordinated Interests. |

3. *Treatment of Claims and Interests under the Plan*

The Classes of Claims against and Interests in the Debtors shall be treated under the Plan as set forth in the Plan, particularly as set forth in Article II and IV thereof.

D. <u>Objections to Claims and Interests</u>

1. *Objection Deadline.*

As soon as practicable, but in no event later than the later of (a) the Effective Date or (b) thirty (30) days after a Claim is filed after the Effective Date or filing and service of a Notice of Lien, unless extended by order of the Bankruptcy Court, all objections to Claims, Liens, and Interests not otherwise deemed released or extinguished by Final Order of the Court shall be filed with the Bankruptcy Court and served upon the holders of each of the Claims, Liens, and Interests to which objections are made. The Reorganized Debtors retain the right to object to late-filed and all other Claims, Liens, and Interests, including Claims filed pursuant to sections 502(g), (h), and (i) of the Bankruptcy Code. No amendments to previously filed Claims shall be allowed after the objection deadline provided in this paragraph. The Debtors and the Reorganized Debtors reserve all rights whatsoever to object to or subordinate any Claims, Liens, and Interests whatsoever on any grounds and to raise any and all defenses, counterclaims, crossclaims, setoffs, and/or recoupments, in law or in equity or pursuant to § 502(d) of the Bankruptcy Code.

2. *Prosecution of Objections and Estate Actions.*

On and after the Effective Date, the filing, litigation, settlement, or withdrawal of all objections to Claims or Estate Actions may be made solely by the Reorganized Debtors.

E. <u>Provisions Governing Executory Contracts and Unexpired Leases Under the Plan</u>

1. *Assumption of Certain Contracts; Rejected if Not Assumed.*

The Plan constitutes and incorporates a motion to assume, as of the Effective Date, the Contracts listed in the Plan ("<u>Executory Contract Schedule</u>"). Any cure amounts for such Contracts pursuant to Bankruptcy Code section 365(b)(1)(A) are de minimis. Confirmation of the Plan shall be deemed (i) adequate assurance of prompt cure of any default under such Contracts solely based upon the Reorganized Debtors' obligations in the Plan to make the Cure Payments and (ii) adequate assurance of future performance under such Contracts. Other than the Contracts listed in the Plan, the Plan constitutes and incorporates a motion to reject, as of the Effective Date (the "Rejection Deadline"), all Contracts to which the Debtors is a party unless there is pending with the Bankruptcy Court as of the Rejection Deadline (a) a motion filed by the Reorganized Debtors to assume any such Contract, or (b) a motion filed by the Reorganized Debtors to extend the Rejection Deadline. Entry of the Confirmation Order by the Bankruptcy Court constitutes approval of such rejections pursuant to sections 365(a) and 1123 of the Bankruptcy Code. It is the Debtors' intention to assume all known executory contracts through the Plan.

2. *Bar to Rejection Damages.*

If the rejection of a Contract by the Debtors pursuant to the Plan results in damages to the other party or parties to such Contract, a Claim for such damages, if not heretofore evidenced by a filed proof of Claim, shall be forever barred and shall not be enforceable against the Debtors, the Reorganized Debtors, or their respective property or their agents, successors or assigns, unless a proof of Claim is filed with the Bankruptcy Court and served upon the Reorganized Debtors on or before thirty (30) days following the Rejection Deadline.

3. *Insurance Policies.*

Notwithstanding any other provision of the Plan, all unexpired insurance policies under which the Debtors are the insured party shall be deemed assumed as of the Effective Date.

4. *Timing of Cure Payments.*

Except as ordered by prior order of the Court or in a specific provision of the Plan, all Cure Payments shall be made (a) by the Reorganized Debtors in twelve (12) equal monthly installments beginning on the Class 4 Distribution Date, or (b) at the Debtors' option, in full on the Class 4 Distribution Date.

F. Miscellaneous Provisions of the Plan

1. *Setoff and Other Rights.*

In the event that the Debtors have claims of any nature whatsoever against the holder of a Claim, the Debtors may, but are not required to, setoff against the Claim (and any payments or other distributions to be made in respect of such Claim hereunder), subject to the provisions of section 553 of the Bankruptcy Code. Neither the failure to setoff nor the allowance of any Claim under the Plan shall constitute a waiver or release by the Debtors of any claim that the Debtors have against the holder of a Claim. It is the Debtors' position that a holder of a Claim who owes the Debtors a contract balance should not be entitled to setoff the amount owed to the Debtors if such contract balance is necessary for the Debtors' successful reorganization.

2. *Discharge.*

Except as otherwise expressly provided in the Plan, the rights and treatment afforded in the Plan shall discharge all existing security interests, liens, debts and Claims of any kind, nature, or description whatsoever against the Debtors or any of their assets or properties to the fullest extent permitted by section 1141 of the Bankruptcy Code; upon the Effective Date, all existing Claims against the Debtors shall be, and shall be deemed to be, discharged, and all holders of Claims shall be precluded from asserting against the Debtors, or any of their assets or properties, any other or further Claim based upon any act or omission, transaction, or other activity of any kind or nature that occurred prior to the Effective Date, whether or not such holder filed a proof of Claim. Confirmation of the Plan and the obligations imposed on the Debtors and/or the Reorganized Debtors herein shall be in complete satisfaction, discharge and release of all Claims of any nature whatsoever against the Debtors and/or the Reorganized Debtors or any of their assets or properties; and, upon the Effective Date, the Debtors shall be deemed discharged, and released from any and all Claims, including but not limited to demands and liabilities that arose before the Effective Date, and all debts of the kind specified in sections 502(g), 502(h), or 502(i) of the Bankruptcy Code that arose before the Effective Date, whether or not (a) a proof of Claim based upon such debt is filed or deemed filed under section 501 of the Bankruptcy Code, (b) a Claim based upon such debt is Allowed under section

502 of the Bankruptcy Code, or (c) the holder of a Claim based upon such debt has accepted the Plan. Except as provided herein, the Confirmation Order shall be a judicial determination of discharge of all liabilities of the Debtors. As provided in section 524 of the Bankruptcy Code, such discharge shall void any judgment against the Debtors at any time obtained, to the extent it relates to a Claim, discharged and operates as an injunction against the prosecution of any action against the Debtors, or their property, to the extent it relates to a Claim discharged. The discharge granted herein shall not discharge the Reorganized Debtors from the obligations in the Plan.

*3.* ***Injunctions***.

*The Confirmation Order shall contain such temporary and permanent injunctions as may be necessary and appropriate to enable the Plan Proponents to implement and perform under the Plan. Without limiting the generality of the foregoing, such injunctions shall include an absolute prohibition from collecting Claims in any manner other than as provided for in the Plan. The Confirmation Order shall contain such injunctions as may be necessary or helpful to effectuate the discharge of the Debtors provided herein. Without limiting the generality of the foregoing, such injunction shall include an absolute prohibition from pursuing or collecting Claims in any manner other than as provided for in the Plan, including any shareholder derivative claims, trust fund liabilities, constructive trusts, statutory trusts, or liabilities arising from contribution, subrogation, warranty, indemnification or guarantee agreements whether as a representative of the Debtors or on an individual basis, or any foreclosure actions by any Lien claimant.*

*4.* ***Injunction Regarding Claims Against the Debtors.***

*From and after the Confirmation Date, all persons or entities that hold, have held, or may hold Claims against or Interests in the Debtors are permanently restrained and enjoined from, directly or indirectly:*

*(a) Commencing or continuing in any manner any action or other proceeding of any kind against the Debtors or the Reorganized Debtors, or Assets of the Debtors to collect or recover any property on account of any such Claim or Interest;*

*(b) Enforcing, attaching, collecting, or recovering by any manner or means any judgment, award, decree, or order to collect or recover any property on account of any such Claim or Interest against the Debtors or the Reorganized Debtors, or Assets of the Debtors;*

*(c) Creating, perfecting, or enforcing any Lien or encumbrance of any kind against the Debtors or the Reorganized Debtors, or the Assets of the Debtors;*

*(d) Asserting any right of setoff, subrogation, or recoupment of any kind against any obligation due the Debtors or the Reorganized Debtors, or the Assets of the Debtors, except as otherwise allowed by the Bankruptcy Court or Bankruptcy Code;*

*(e) Commencing or continuing any action against the Debtors or the Reorganized Debtors, or the Assets of the Debtors in any manner or forum in respect of such Claim or Interest that does not conform to or comply with or that is inconsistent with the Plan; and*

*(f) Taking any action to interfere with the implementation or consummation of the Plan.*

Notwithstanding the foregoing, however, nothing herein shall prohibit any holder of a Claim or Interest from prosecuting a proof of Claim or Interest in the Bankruptcy Case or from enforcing such holder's rights under the Plan.

*5.* ***Exculpation and Release***.

*Neither the Debtors nor Co-Plan Proponent, nor their respective Representatives, including without limitation their attorneys, shall have or incur any liability to any holder of a Claim or Interest for any act, event, or omission in connection with, or arising out of, the Bankruptcy Cases, the confirmation of the Plan, the consummation of the Plan, or the administration of the Plan or the property to be distributed under the Plan, except for willful misconduct or gross negligence. As of the Effective Date, each employee, officer, and director of the Debtors who served in such capacity from and after the Petition Date, the Debtors and Co-Plan Proponent, and the Representatives, including without limitation their attorneys, shall be deemed to be released from all claims, demands, and suit, known or unknown, fixed or contingent, liquidated or unliquidated, whether or not asserted, which may be held or asserted by the Debtors, Reorganized Debtors, or any current or former holder of a Claim or Interest regarding or related to the Debtors or the Debtors' business operations within the Bankruptcy Cases from the Petition Date to the Effective Date, other than the obligations under the Plan, except for willful misconduct or gross negligence.*

*6. Lawsuits.*

Upon entry of the Confirmation Order, all lawsuits, litigation, administrative, police, or regulatory actions, or other proceedings, judicial or administrative, in connection with the assertion of a Claim or Lien against the Debtors or the Representatives or property of the Debtors' estates, shall be subject to the discharge and any other injunctions set forth in the Bankruptcy Code or the Court's Confirmation Order. Such discharge injunctions shall be with prejudice to the assertion of such Claim or Lien in any manner other than as prescribed by the Plan. All parties to any such action shall be enjoined by the Bankruptcy Court in the Confirmation Order from taking any action in violation of the Bankruptcy Code or the Confirmation Order. All lawsuits, litigation, administrative, or any other proceedings, judicial or administrative, in connection with the assertion of any Claims by the Debtors shall become property of the Reorganized Debtors to prosecute, settle, or dismiss as the Reorganized Debtors see fit. Notwithstanding the foregoing, the prosecution of the Burlington Adversary described herein shall not be enjoined, and shall be determined by this Court.

*7. Insurance.*

Confirmation and consummation of the Plan shall have no effect on assumed insurance policies of the Debtors in which the Debtors are or were the insured party; the Reorganized Debtors shall become the insured party or parties under any such policies. Each insurance company is prohibited from, and the Confirmation Order shall include an injunction against, denying, refusing, altering, or delaying coverage on any basis regarding or related to the Debtors' bankruptcy, the Plan, or any provision within the Plan.

*8. Post-Effective Date Fees and Expenses of Professional Persons.*

The Reorganized Debtors shall, in the ordinary course of business and without the necessity for any notice, motion, Fee Application, or approval by the Bankruptcy Court, pay the reasonable fees and expenses arising post-Effective Date of the Professional Persons employed by the Reorganized Debtors. Any disputes regarding such fees and expenses shall be submitted to the Bankruptcy Court.

*9. Bankruptcy Restrictions.*

From and after the Effective Date, the Reorganized Debtors shall no longer be subject to the restrictions and controls provided by the Bankruptcy Code (e.g., section 327, 330, 363, 364) or Bankruptcy Rules (except with respect to Claim objections and avoidance or recovery of Estate Actions under bankruptcy law), the Bankruptcy Court, or the United States Trustee's guidelines (however, the Reorganized Debtors shall provide the United States Trustee such quarterly financial reports as are required until the entry of a final decree). The Reorganized Debtors may compromise claims and controversies post-Effective Date without the need of notice or Bankruptcy Court approval. Post-Effective Date, the Reorganized Debtors may operate their business in such manner as is consistent with companies not in bankruptcy without the need of seeking Bankruptcy Court approval with regard to any aspect of the Reorganized Debtors' business, except that the Reorganized Debtors shall comply with all terms of the Plan.

*10. Binding Effect.*

The Plan shall be binding upon and inure to the benefit of the Debtors, the holders of Claims, the holders of Interests, and all of their respective successors and assigns; provided, however, that if the Plan is not confirmed, the Plan shall be deemed null and void and nothing contained herein shall be deemed (a) to constitute a waiver or release of any Claims by the Debtors or any other person, (b) to prejudice in any manner the rights of the Debtors or any other person or holders if any Claim or (c) to constitute any admission by the Debtors or any other person.

*11. Governing Law.*

Unless a rule of law or procedure is supplied by federal law (including the Bankruptcy Code and Bankruptcy Rules) or the law of the jurisdiction of organization of any entity, the internal laws of the State of Texas shall govern the construction and implementation of the Plan and any agreements, documents, and instruments executed in connection with the Plan or the Bankruptcy Case, including the Plan Documents and any documents executed pursuant to the Plan.

*12. Modification or Revocation of Plan.*

Modifications of the Plan may be proposed in writing by the Debtors at any time before the Confirmation Date, provided that (a) the Plan, as modified, meets the requirements of sections 1122 and 1123 of the Bankruptcy Code; (b) the Debtors shall have complied with section 1125 of the Bankruptcy Code; (c) such modification otherwise complies with the Bankruptcy Code; and (d) the Co-Proponent consents to such modification in writing. The Plan may be modified at any time after the Confirmation Date and before substantial consummation by the Debtors, provided that (i) the Plan, as modified, meets the requirements of sections 1122 and 1123 of the Bankruptcy Code, (ii) the Bankruptcy Court, after notice and a hearing, confirms the Plan as modified under section 1129 of the Bankruptcy Code, and (iii) the Debtors serves creditors with any proposed modification and notice of hearing for same, (iv) the circumstances warrant such modifications, and (v) the Co-Proponent consents to such modification in writing. A holder of a Claim or Interest that has accepted or rejected the Plan shall be deemed to have accepted or rejected, as the case may be, such Plan as modified, unless, within the time fixed by the Bankruptcy Court, such holder changes its previous acceptance or rejection.

The Plan Proponents reserve the right to revoke and/or withdraw the Plan prior to entry of the Confirmation Order. If the Plan Proponents revoke and/or withdraw the Plan, or if confirmation of the Plan does not occur, then the Plan shall be deemed null and void and nothing contained herein shall be deemed (a) to constitute a waiver or release of any Claims by the Debtors or any other person, (b) to prejudice in any manner the rights of the Debtors or any other person, or (c) to constitute an admission by the Debtors or any other person.

*13. Creditor Defaults.*

Any act or omission by a creditor in contravention of a provision within the Plan shall be deemed an event of default under the Plan. Upon an event of default that remains uncured after notice and opportunity to cure, sufficient under the circumstances, the Reorganized Debtors may seek to hold the defaulting party in contempt of the Confirmation Order. If such creditor is found to be in default under the Plan, such party may be required to pay the reasonable attorneys' fees and costs of the Reorganized Debtors in pursuing such matter. Furthermore, upon the finding of such a default by a creditor, the Bankruptcy Court may (a) designate a party to appear, sign and/or accept the documents required under the Plan on behalf of the defaulting party, in accordance with Rule 70 of the Federal Rules of Civil Procedure, or (b) issue and enter such other order as may be equitable which does not materially alter the terms of the Plan as confirmed.

*14. Debtors' Default.*

In the event that the holder of an Allowed Claim asserts that a default under the Plan has occurred, such person must provide the Plan Proponents and their respective counsel with written notice of such default and a reasonable opportunity to cure. If the default asserted in the notice remains uncured after the thirtieth (30th) day from the date on which such notice is received by the Plan Proponents and their respective bankruptcy counsel, the holder of such Allowed Claim may pursue any rights or remedies it may have under the Plan, applicable non-bankruptcy law, whether state, federal, or otherwise, including in the Bankruptcy Court.

*15. Disallowance and Subordination of Subordinated Claims and Penalty Claims.*

The Debtors reserve all rights to seek subordinated classification of any and all Claims or Interests to Subordinated Claims, Penalty Claims, and Subordinated Interests pursuant to any applicable bankruptcy or non-bankruptcy law or agreement, whether in law or in equity. The Reorganized Debtors shall constitute the representatives of the estate for purposes of prosecuting Estate Actions and pursuant to section 1123(b)(2)(B) of the Bankruptcy Code.

*16. Release of Claims.*

Upon final payment required by the Plan, the Debtors shall be released from any and all Claims and causes of action of the Reorganized Debtors or the Debtors' estates that could be asserted against such Persons pursuant to the Plan, and the Reorganized Debtors shall be discharged from their duties and powers under the Plan.

*17. Integration Clause.*

The Plan is a complete, whole, and integrated statement of the binding agreement between the Debtors, creditors, and the parties-in-interest upon the matters herein.

*18. Retention of Causes of Action.*

The Reorganized Debtors shall retain, all rights, claims, defenses, and causes of action including, but not limited to, the Estate Actions not assigned to the Creditor Trust, and shall have sole authority to prosecute and/or settle such actions without approval of the Bankruptcy Court under Bankruptcy Rule 9019 or otherwise.

*19. Severability.*

Should the Bankruptcy Court determine that any provision of the Plan is unenforceable either on its face or as applied to any Claim or Interest or transaction, the Debtors may modify the Plan in accordance with Article 17.12 of the Plan so that such provision shall not be applicable to the holder of any Claim or Interest. Such a determination of unenforceability shall not (a) limit or affect the enforceability and operative effect of any other provision of the Plan or (b) require the resolicitation of any acceptance or rejection of the Plan.

*20. Notice to the Plan Proponents.*

Notice required by the Plan shall be sent as follows:

| | |
|---|---|
| Jon Bretley Bennett, President<br>ReoStar Energy Corporation<br>3880 Hulen Street, Suite 500<br>Fort Worth, Texas 76107<br>Telephone: (817) 732-8739<br>Facsimile: (817) 732-8762<br>E-mail: brett@reoenergy.com<br><br>and to:<br><br>R. Kevin Russell, COO<br>Russco Energy LLC<br>515 N. Fredonia<br>Longview, TX 75601<br>Telephone: (903) 753-0242<br>Facsimile: (903) 753-3738<br>E-mail: toledogas@msn.com | with copy to:<br><br>Bruce W. Akerly<br>Texas Bar No. 00953200<br>bakerly@canteyhanger.com<br>Arthur A. Stewart<br>Texas Bar No. 19203500<br>astewart@canteyhanger.com<br>CANTEY HANGER LLP<br>1999 Bryan Street, Suite 3330<br>Dallas, Texas 75201<br>Telephone: (214) 978-4129<br>Facsimile: (214) 978-4150<br><br>COUNSEL FOR<br>THE DEBTORS-IN-POSSESSION<br><br>Stephanie D. Curtis<br>Texas Bar No. 05286800<br>scurtis@curtislaw.net<br>Mark A. Castillo<br>Texas Bar No. 24027795<br>mcastillo@curtislaw.net<br>CURTIS \| CASTILLO PC<br>Bank of America Plaza<br>901 Main Street, Suite 6515<br>Dallas, Texas 75202<br>Telephone: 214.752.2222<br>Facsimile: 214.752.0709<br><br>COUNSEL FOR CO-PROPONENT<br>RUSSCO ENERGY LLC |

*21. Substantial Consummation/Closing the Case.*

Upon completion of the actions to be taken pursuant to Article 2 of the Plan, the Plan shall be deemed substantially consummated and, upon motion by the Reorganized Debtors, a final decree entered containing such provisions as may be equitable. The Court may retain jurisdiction to hear and decide: (a) any and all pending adversary proceedings, applications, and contested matters, including any remands of appeals; (b) any and all pending objections to Claims or the allowance, including with respect to the classification, priority, estimation, or payment of any Claim; and (c) any and all pending Fee Applications.

## VIII. MEANS FOR EXECUTION OF THE PLAN

A. Powers and Duties of the Reorganized Debtors with Respect to Consummation of the Plan.

Under the Plan, the Reorganized Debtors are empowered to: (a) take all steps and execute all instruments and documents necessary to effectuate the Plan; (b) make distributions and payments contemplated by the Plan; (c) comply with the Plan and the obligations thereunder; (d) employ, retain, or replace Professional Persons to represent them with respect to their responsibilities; (e) object to Claims; (f) prosecute the Estate Actions; and (g) exercise such other powers as may be vested in the Reorganized Debtors pursuant to order of the Court or pursuant to the

Plan or as the Reorganized Debtors deems to be necessary and proper to carry out the provisions of the Plan. The Reorganized Debtors shall have the duties of carrying out the provisions of the Plan, which shall include taking or not taking any action that the Reorganized Debtors deem to be in furtherance of the Plan.

The Plan shall set out the treatment and means for establishment and implementation of the Creditor Trust.

B. New Equity in Reorganized Debtors.

All Class 6 Interests in the Debtors shall be canceled as of the Effective Date.

New interests shall be sold to the Interested Purchaser(s). The Debtors s**hall accept the highest amount offered** for the new equity in the Reorganized Debtors **to the Debtors on or before the Confirmation Hearing,** which amount will be accepted by the Debtors for the purchase of interests in the Reorganized Debtors. Pursuant to the *Bank of America Nat'l Trust v. 203 North LaSalle Street Partnership*, 526 US 434, 457, 199 S. Ct. 1411, 143 L.Ed. 2d 607 (1999), the Debtors are requesting any party interested in purchasing the new equity of the Reorganized Debtors to make offers for the purchase of the new equity in the Reorganized Debtors. At a minimum, the Interest Purchase Price shall be:

Russco Energy LLC– 65% of the new interests in the Reorganized Debtors for the Interest Purchase Price of $325,000 Cash on the Effective Date and the provision of $13 million in working capital within one year of the Effective Date;

The Rife/Bennett Group – 35% of the new interests in the Reorganized Debtors for the Interest Purchase Price of $175,000 Cash on the Effective Date.

This is not an exclusive opportunity for Rife/Bennett Group or Russco; instead, the Debtors are requesting any interested party to put forth an offer in writing to the Debtors, no later than ten (10) days prior to the hearing on Confirmation, for the purchase of the new interests. Upon receipt of any such viable offer, the Debtors' shall begin to cooperate with potential bidders by providing requested information after investigation into whether such offerors hold any competing interests to those of the Debtors, execution of appropriate non-compete and non-disclosure agreements, and provision of proof of financial ability to fund. At this time, Russco Energy LLC has provided the Debtors with the term sheet attached as Exhibit F and proof of financial ability to fund, attached as Exhibit G. Further, the Rife/Bennett Group has provided the Debtor with the proof of financial ability to fund attached as Exhibit H. The Debtors reserve the exclusive right to review and accept finalized offers if received less than ten (10) days prior to the hearing on Confirmation if it is deemed by the Debtors to be in the best interests of their estates to do so. Although the Debtors will accept higher bids for the equity in the Reorganized Debtors and no fairness opinions or formal valuations have been sought, the Debtors determined the proposed consideration by Russco and the Rife/Bennett Group to be fair and reasonable based on their collective experience in the oil and gas industry regarding what the market would pay for the equity of a company like ReoStar.

Russco Energy LLC, the Rife/Bennett Group, their designees, or such other entity or entities announced prior to the Confirmation Date shall (i) pay the Interest Purchase Price, by the Effective Date, to purchase the new equity in the Reorganized Debtors to fund the Reorganized Debtors' ability to negotiate, prepare, solicit, prosecute, confirm, and make Cash distributions under, the Plan; and (ii) advance funds necessary for the Reorganized Debtors to fulfill the requirements of the Plan. The Interest Purchasers may include Russco Energy LLC, The Rife/Bennett Group, or their designees, including an energy drilling fund. Mr. Trey Rife is the current CEO of the Debtor and shall continue to provide services to the Reorganized Debtors post-confirmation, and has agreed to sell his interests in Rife Energy Operating, Inc. to the Debtors. Russco Energy LLC shall secure the infusion of $13 million in funds for the Reorganized Debtors' working capital needs post-confirmation in exchange for its Interests and assist the Debtors in obtaining a loan, if necessary, for any ultimate payment of BT & MK's Allowed Secured Claims under the Plan. As such, Russco Energy LLC and Mr. Trey Rife are integral to the successful implementation of the Plan. Additionally, the Debtors' issuance of stock to the Rife/Bennett Group, is expressly conditioned upon *(i*) purchase of all interests in Rife Energy Operating Co., for $3.2 million in the form of a secured promissory note (the "Note") payable in equal monthly installments of approximately $50,000, until paid in full; and the Note shall accrue interest at five and one half percent (5.5%) per year, *(ii)* continued services by M.O. Rife, III to the Reorganized Debtors for, at a minimum, the duration of the Reorganized Debtors' performance under the Plan and Note, and (*iii*) a non-compete agreement between M.O. Rife, III and the Reorganized Debtors, in a form acceptable to Mr. Rife, the Debtors or Reorganized Debtors, and Russco, to further secure Mr. Rife's services to the Reorganized Debtors for, at a minimum, the duration of the Reorganized Debtors' performance under the Plan and Note.

Although no fairness opinions or formal valuations have been sought regarding the value of Rife Energy or value of Mr Rife's services, the Debtors believe the consideration to be received from the Rife Energy transaction to be fair and reasonable because (1) the purchase of Rife Energy for $3,200,000 equates to Rife Energy's cash flow over five years and, based on Rife's cash flow projections, the Debtors anticipate this cash flow to continue for at least 10-15 years and, in addition, the acquisition of Rife Energy will greatly enhance the overall value of the Debtors; and (2) based on Mr. Rife's long experience in the oil and gas industry, Mr. Rife's post-confirmation services are invaluable to the Debtors' long term success.

Russco, Rife/Bennett Group and the Debtors must complete the above described transactions in order for the Debtors to successfully reorganize. If Russco, Rife/Bennett Group or the Debtors fail to complete any of the transactions, the Debtors will not have a feasible plan. However, Russco, Rife/Bennett Group have the ability to close all of the above described transactions and will provide evidence of this at the confirmation hearing on the Plan. Neither Russco nor the Rife/Bennett Group have any competing interests to those of the Debtors, and will, upon confirmation execute appropriate non-compete documentation.

C. Officers and Directors.

After the Effective Date, the current officers and directors of the Debtors shall no longer continue to serve as officers and directors of the Reorganized Debtors. As of the Effective Date, the Board of the Reorganized Debtors shall consist of R. Kevin Russell, M.O. Rife, III, Jon Bretley Bennett, Raymond S. Russell, and Benton J. Poole. The officers shall be appointed as follows: CEO – M.O. Rife III; COO – R. Kevin Russell; President – Jon Bretley Bennett; CFO – Raymond S. Russell; and VP Legal Benton J. Poole.

The newly appointed officers and directors of the Reorganized Debtors shall be subject to subsequent shareholders' meetings in the course of the Reorganized Debtors' ordinary corporate governance of a privately held company. The Reorganized Debtors will be a privately held company, and no longer be publically held as of the Effective Date.

D. Vesting of Assets.

On the Effective Date, all real and personal property of the estates of the Debtors, including but not limited to all Estate Actions not assigned to the Creditor Trust, shall vest in the Reorganized Debtors. Except as expressly provided in the Plan, all assets of the Debtors shall vest free and clear of all Claims, Interests and Liens or successor liability claims in the Reorganized Debtors, which shall be owned and controlled as set out in the Plan.

E. Corporate Purpose of the Reorganized Debtors.

From and after the Effective Date, the Reorganized Debtors shall operate as privately held companies and be authorized to operate in the ordinary course of business and shall be authorized to make the distributions required under, and implement the provisions of, the Plan.

F. Assumption of Liabilities.

The liability for and obligations under the Plan shall be assumed by and become obligations of the Reorganized Debtors.

G. Contested Claims.

On and after the Effective Date, the filing, litigation, settlement, or withdrawal of any and all objections to Claims or Estate Actions not assigned to the Creditor Trust may be made solely by the Reorganized Debtors. Treatment for such claims shall be set forth in the Plan.

H. Estimated Claims.

Except as otherwise provided herein and for the BT & MK Claims, the Court may estimate for purposes of allowance pursuant to section 502(c) of the Bankruptcy Code, (i) any Contested Claim or unliquidated Claim, or (ii) any portion or part of a Claim that is, itself, unliquidated. Any Estimation Order, to the extent it becomes a Final Order, shall determine the amount of the Allowed Claim so estimated.

I. Provisions Governing Distributions.

Distributions for claims shall be governed by the Plan.

*Exculpation Regarding Distributions.*

Upon the Final Distribution Date and so long as there have been no uncured defaults under the Plan, the Plan Proponents and their respective Representatives, shall be discharged, and released by all persons, holders of Claims or Interests, entities, and parties-in-interest receiving distributions under the Plan from any and all claims, causes of action, and other assertions of liability arising out of the Reorganized Debtors' discharge of the powers and duties conferred upon them by the Plan or any order of the Bankruptcy Court entered pursuant to or in furtherance of the Plan or applicable law. No current holder of a Claim or an Interest, and no representative thereof, shall have or pursue any claim or cause of action (a) against the Plan Proponents or their Representatives for making payments or taking any action in accordance with the Plan or for implementing the provisions of the Plan, or (b) against any holder of a Claim for receiving or retaining payments or other distributions as provided for by the Plan. The Representatives are hereby indemnified and held harmless by the Reorganized Debtors for any Claims, causes of action, and other assertions of liability arising out of the discharge of the powers and duties conferred upon them by the Plan or any orders of the Bankruptcy Court entered pursuant to or in furtherance of the Plan or applicable law, except only for actions or omissions arising out of the Representatives' gross negligence or willful misconduct.

J. Conditions Precedent to Effective Date.

*1. Conditions Precedent to Effective Date of the Plan.*

The occurrence of the Effective Date of the Plan is subject to satisfaction of the following conditions precedent: the Confirmation Order must contain approval of the proposed Class treatment and the injunctions contained in the Plan, and the Confirmation Order shall have become final and non-appealable, all documents effectuating the Plan must have been executed and delivered by the parties thereto, all conditions to the effectiveness of such documents must have been satisfied or waived as provided therein, and the Co-Proponent shall have reviewed and approved each of the foregoing conditions in writing. The Reorganized Debtors shall file a Notice of Effective Date with the Bankruptcy Court within two Business Days of the occurrence of the Effective Date. Unless the Court orders otherwise for cause shown, the Effective Date shall occur no later than 30 days after the Confirmation Order becomes final and non-appealable.

*2. Waiver of Conditions.*

The conditions to the Effective Date may be waived, in whole or in part by the Debtors, at any time, without notice except to Co-Proponent, who must be consulted and consent in writing to any such waiver. The failure to satisfy or waive any condition may be asserted by the Debtors, without Co-Proponent's written consent, regardless of the circumstances giving rise to the failure (including any actions or inaction by the Debtors). The failure of the Debtors to exercise any of the foregoing rights, subject to Co-Proponent's written consent, shall not be deemed a waiver of any other rights and each right shall be deemed an ongoing right that may be asserted at any time.

K. Retention of Bankruptcy Court Jurisdiction.

*1. Scope of Jurisdiction.*

The Bankruptcy Court shall retain jurisdiction:

(a) To hear and determine pending applications for the assumption or rejection of Contracts and the allowance of Claims resulting therefrom;

(b) To hear and determine any and all adversary proceedings, applications, and contested matters, including any remands of appeals, and including any Estate Actions; provided, however, that the Reorganized Debtors shall not be required to seek or obtain approval of the Bankruptcy Court under Bankruptcy Rule 9019 or otherwise as to the settlement or compromise of any Estate Actions post-Effective Date;

(c) To ensure that distributions to holders of Allowed Claims are accomplished as provided herein;

(d) To hear and determine any timely objections to or applications concerning Claims or the allowance, classification, priority, estimation, or payment of any Claim or Interest, and to enter Estimation Orders;

(e) To hear and determine all Fee Applications and Fee Claims; provided, however, that the Reorganized Debtors shall not be required to seek or obtain approval of the Bankruptcy Court under section 330 of the Bankruptcy Code or otherwise as to the allowance or payment of professional fees post-Effective Date;

(f) To enter and implement such orders as may be appropriate in the event the Confirmation Order is for any reason stayed, revoked, modified, reversed, or vacated;

(g) To hear and determine disputes arising in connection with the execution, interpretation, implementation, consummation, or enforcement of the Plan;

(h) To enter and implement such orders as may be necessary or appropriate to execute, interpret, implement, consummate, or enforce the Plan and the transactions contemplated thereunder;

(i) To consider any modification of the Plan pursuant to section 1127 of the Bankruptcy Code, to cure any defect or omission or to reconcile any inconsistency in any order of the Bankruptcy Court, including, without limitation, the Confirmation Order;

(j) To enter and implement orders or take such other actions as may be necessary or appropriate to restrain interference by any entity with the consummation or implementation of the Plan, including, without limitation, to issue, administer and enforce injunctions provided for in the Plan and the Confirmation Order;

(k) To recover all assets of the Debtors and property of the estates, wherever located;

(l) To hear and determine matters concerning state, local, and federal taxes in accordance with sections 346, 505, and 1146 of the Bankruptcy Code;

(m) To hear and determine any other matter not inconsistent with the Bankruptcy Code and title 28 of the United States Code that may arise in connection with or related to the Plan; and

(n) To enter a final decree closing the Bankruptcy Case, or to reopen the Bankruptcy Case in conformance with the Bankruptcy Code and the Plan, including without limitation to allow for recovery of Estate Actions.

2. *Failure of the Bankruptcy Court to Exercise Jurisdiction.*

If the Bankruptcy Court abstains from exercising, or declines to exercise, jurisdiction or is otherwise without jurisdiction over any matter arising in, arising under, or related to the Bankruptcy Case, Article 14 of the Plan will have no effect upon and will not control, prohibit, or limit the exercise of jurisdiction by any other court having jurisdiction with respect to such matter.

L. The Liquidation Creditor Trust.

The Plan shall govern the establishment and implementation of the Creditor Trust for the benefit of the Debtors' creditors.

## IX. FEASIBILITY AND RISKS

Section 1129(a)(11) of the Bankruptcy Code requires a finding that confirmation of the Plan is not likely to be followed by the liquidation, or the need for further financial reorganization, of the Debtors or any successor in interest, unless liquidation is expressly contemplated by the Plan. The Debtors' business plan underlies the projections set forth below.

**THE PROJECTED FINANCIAL INFORMATION AND OTHER FORWARD-LOOKING STATEMENTS CONTAINED IN THIS DISCLOSURE STATEMENT ARE BASED ON VARIOUS ASSUMPTIONS AND ESTIMATES AND WILL NOT BE UPDATED TO REFLECT EVENTS OCCURRING AFTER THE DATE HEREOF. SUCH INFORMATION AND STATEMENTS ARE SUBJECT TO INHERENT UNCERTAINTIES AND TO A WIDE VARIETY OF SIGNIFICANT BUSINESS, ECONOMIC AND COMPETITIVE RISKS INCLUDING, AMONG OTHERS, THOSE DESCRIBED HEREIN. CONSEQUENTLY, ACTUAL EVENTS, CIRCUMSTANCES, EFFECTS AND RESULTS MAY VARY SIGNIFICANTLY FROM THOSE INCLUDED IN OR CONTEMPLATED BY SUCH PROJECTED FINANCIAL INFORMATION AND SUCH OTHER FORWARD-LOOKING STATEMENTS**.

A. Management's Discussion of Financial Projections

This Section and related exhibits summarize the arithmetic projections and results, presented in the form of financial projections, of the business plan described herein pursuant to which the business of the Debtors will be carried on by the Reorganized Debtors after confirmation of the Plan.

The chart attached as Exhibit B to the Disclosure Statement details the Debtors' business operations for years beginning October 2011 through October 2014, and are based on Forrest A. Garb & Associates, Inc. reserve report estimates, after application of a 20% risk factor. The Plan Projections contemplate infusion of $13.5 million of new working capital in the forms of equity, senior and junior debt into the Debtors, as follows: $500,000 of equity on the Effective Date; $8 million of additional equity within 90 days of the Confirmation Order becoming a Final Order; and an additional $5 million of mezzanine debt within 120 days of the Confirmation Order becoming a Final Order. See Plan Sources and Uses of Capital Funding attached to Exhibit "B." Exhibit "C" to the

Disclosure Statement details the liquidation analysis if the Debtors were to liquidate under Chapter 7 rather than reorganize under Chapter 11.

B. Risks

The Plan is subject to a number of material risks, including those enumerated below. Prior to deciding how to vote on the Plan, each holder of an impaired Claim and holder of an Interest should carefully consider all of the information contained in this Disclosure Statement, especially the factors mentioned in the following paragraphs.

*1. Certain Risks of Non-Confirmation*

There can be no assurance that the requisite acceptances to confirm the Plan will be received. Even if the requisite acceptances are received, there can be no assurance that the Court will confirm the Plan. Section 1129 of the Bankruptcy Code sets forth the requirements for confirmation and requires, among other things, a finding by the Court that the confirmation of the Plan is not likely to be followed by a liquidation or a need for further financial reorganization and that the value of the distributions to non-accepting holders of Claims and Interests will not be less than the value of the distributions that such holders would receive if the Debtors were liquidated under Chapter 7 of the Bankruptcy Code. Although the Debtors believe that these requirements will be satisfied, there can be no assurance that the Court will concur. The confirmation and consummation of the Plan also are subject to certain conditions, which are described in Articles III and VIII of this Disclosure Statement.

If the Plan were not to be confirmed and consummated, it is unclear whether a reorganization comparable to the reorganization contemplated hereby could be implemented in a timely manner and, if so, what distributions holders of Claims and Interests ultimately would receive with respect to their Claims and Interests. Moreover, if an alternative reorganization could not be implemented in a timely manner, it is possible that the Debtors would have to liquidate their assets, in which case it is likely the holders of Claims and Interests would receive substantially less than they would have received pursuant to the Plan. *See* Article X of this Disclosure Statement.

*2. Potential Effects of a Prolonged Chapter 11 Proceeding*

While management expects the Debtors' financial condition to improve over the next several months as their turnaround plan is fully implemented, it remains the case that prolonged Chapter 11 proceedings could have adverse effects on the Debtors, including the continuing strain on relationships with vendors and employees, and the continuing accrual of Administrative Expenses relating to the continuation of bankruptcy proceedings.

*3. Risks Relating to the Projections*

The management of the Debtors has prepared the projected financial information contained in Exhibit "B" to this Disclosure Statement (the "Projections") in connection with the development of the Plan to present the projected effects of the Plan and the transactions contemplated hereby. The Projections assume that the Plan and the transactions contemplated hereby will be implemented in accordance with its terms and are based upon numerous other assumptions and estimates. The assumptions and estimates underlying the Projections are inherently uncertain and are subject to significant business, economic, legal, and competitive risks and uncertainties that could cause actual results to differ materially from those projected. Accordingly, the Projections are not necessarily indicative of the future financial condition or results of operations of the Reorganized Debtors, which may vary significantly from those set forth in the Projections. Consequently, the projected financial information contained in this Disclosure Statement should not be regarded as a representation by the Debtors, the Debtors' advisors, or any other person that the Projections can or will be achieved.

*4. Capital Requirements*

The Debtors believe that the Cash generated from ordinary-course operations along with the post-confirmation loans and capital infusion will be adequate to support payment on the Debtors' Administrative Expense Claims, Priority Tax Claims, and Secured Claims; however, there can be no assurance that one or more unexpected necessary capital expenditures will not impact the Debtors materially and adversely, (e.g., fire, flood, or other natural disaster), and no assurance can be given that emergency financing will be available when needed and on reasonable terms.

*5. Forward-Looking Information May Prove Inaccurate*

This Disclosure Statement contains various forward-looking statements and information that are based on management's beliefs as well as assumptions made by and information currently available to management. When used in this document, the words "believe," "expect," "anticipate," and similar expressions are intended to identify forward-looking statements. Such statements are subject to certain risks, uncertainties, and assumptions including those identified above. Should one or more of these risks or uncertainties materialize, or should underlying assumptions prove incorrect, actual results may vary materially from those anticipated, estimated, or projected.

*6. Competition and Economic Factors*

This Disclosure Statement assumes that industry competition and current economic conditions remain relatively unchanged. Any significant increase in competition against the Debtors in their industry, or any changes in the economic condition of the Debtors' usual or expected customer base could have a negative (or positive) affect on the Debtors and their current and future projects and could affect the figures and projections presented in this Disclosure Statement. There can be no assurance that this decline will not continue and that the Debtors' financial performance may therefore continue to decline as well.

*7. Industry Factors*

As stated in the Disclosure Statement, in late 2008 and into 2009, the market price of oil and natural gas sharply declined. The oil and gas market can sometimes be volatile and highly competitive. There can be no assurance that future fluctuations in the oil and gas market will not adversely affect the Debtors' business or financial performance.

## X. <u>ALTERNATIVES TO PLAN</u>

### A. <u>Liquidation Analysis</u>

Section 1129 of the Bankruptcy Code provides that the Court may confirm a plan of reorganization only if certain requirements are met. One of these requirements is that each non-accepting holder of an Allowed Claim or Interest must receive or retain under the Plan, on account of such Claim or Interest, property as of the Effective Date of the Plan at least equal to the value such holder would receive if the Debtors were liquidated under Chapter 7 of the Bankruptcy Code on the Effective Date.

For purposes of the following discussion, it is assumed that a Chapter 7 trustee would seek to maximize the value of the estate by attempting to sell the businesses and assets of the Debtors as going-concerns. However, the Debtors believe that the circumstances surrounding a liquidation under Chapter 7 would inevitably lead to selling conditions that would substantially detract from the total value returned to the estate. Further, there is no assurance that a Chapter 7 trustee will sell the businesses, which would cause a forced liquidation at even more depressed prices. The following are some, but not all, of the deleterious consequences that the Debtors believe would result from a Chapter 7 liquidation:

- Substantial Chapter 7 administrative costs relating to professional fees, broker commissions, sales commissions and other associated expenses would necessarily be incurred. The Debtors estimate these additional fees to approximate $200,000 if the Plan is not accepted and confirmed and the Debtors were to convert to Chapter 7.
- The sale of the Debtors' assets and businesses under the time pressure and adverse publicity attendant to a Chapter 7 liquidation – the inability of the Debtors to acquire operations over the Barnett property in a Chapter 7 scenario, along with flooding the already-saturated local market with similar property and

equipment, would create a difficult selling environment and would result in a transaction consummated at a substantial discount to going-concern value.

- Adverse tax consequences may further reduce the value returned to the estate from a sale of the ongoing operations of the Debtors. An asset sale pursuant to a Chapter 7 liquidation could potentially result in adverse federal income tax consequences to the estate.
- A Chapter 7 trustee will be unfamiliar with the Debtors' business at the time of his/her appointment and is not likely to be in a position to market the Debtors during the liquidation period as effectively as current management, counsel, and advisors.

The Liquidation Analysis reflects an accrual basis of accounting and comports with the Debtors' accounting used in preparing their monthly operating reports. The conclusion of such analysis is that all holders of Claims other than holders of Secured Claims, Administrative Claims, and Priority Tax Claims could expect a dividend of zero dollars. Furthermore, the Debtors expect that the Chapter 7 Trustee's process of winding-down the Debtors' affairs, objections to Claims, and making dividends could take up to two years or longer, due to pending litigation. Thus, a dividend, if one is paid upon liquidation, would not likely be made until 2013 or later.

B. Strategic Purchasers or Investors

The Debtors have discussed potential investment or purchase with certain interested parties, and will continue to consider investors for potential purchase of interests in the Reorganized Debtors as set forth in the Disclosure Statement. However, to date, no party has provided any written offer to the Debtors or even sufficient proof of interest and financial data for the Debtors to expend resources to pursue same.

C. Other Alternative Plans

The Debtors believe that to maximize the going concern value of the Company and, coincidentally maximize the return to creditors, the current Plan is the most desirable and beneficial plan to pursue. Without confirmation of the Plan, the Debtors expect that vendors, employees, and customers will lose confidence in the Debtors, thereby draining the Debtors' Cash and negating any potential for distribution for unsecured creditors.

## XI. CERTAIN UNITED STATES FEDERAL INCOME TAX CONSEQUENCES OF THE PLAN

The following discussion summarizes certain material federal income tax consequences of the implementation of the Plan to the Debtors, and to holders of Claims and Interests. This discussion is based on the Internal Revenue Code of 1986, as amended, Treasury Regulations thereunder, judicial decisions, and published rulings and pronouncements of the IRS in effect on the date of this Disclosure Statement. Changes in these rules, or new interpretations of these rules, may have retroactive effect and could significantly affect the federal income tax consequences described below.

The material U.S. federal income tax consequences of the Plan and the formation and operation of the Trust are complex and subject to uncertainties. Except as provided herein, the Debtors have not requested a ruling from the IRS or an opinion with respect to any of the tax aspects of the Plan. There can be no assurance that the IRS will agree with this discussion of material federal income tax consequences. In addition, this summary does not address state, local, or foreign tax consequences of the Plan, and it does not purport to address the federal income tax consequences of the Plan to special classes of taxpayers (such as foreign taxpayers, broker-dealers, banks, insurance companies, financial institutions, small business investment corporations, regulated investment companies, tax-exempt organizations, or investors in pass-through entities).

**THE FOLLOWING SUMMARY OF CERTAIN MATERIAL U.S. FEDERAL INCOME TAX CONSEQUENCES IS FOR INFORMATIONAL PURPOSES ONLY AND IS NOT A SUBSTITUTE FOR CAREFUL TAX PLANNING AND ADVICE BASED ON THE INDIVIDUAL CIRCUMSTANCES PERTAINING TO A PARTICULAR CREDITOR. ALL HOLDERS OF CLAIMS AND INTERESTS ARE URGED TO CONSULT THEIR OWN TAX ADVISORS IN DETERMINING THE U.S. FEDERAL,**

**STATE, LOCAL, AND OTHER TAX CONSEQUENCES TO THEM IN CONNECTION WITH THE PLAN.**

A. Federal Income Tax Consequences to the Debtors

*1. In General*

Pursuant to the Plan, a significant portion of the outstanding indebtedness of the Debtors is being satisfied at a discount. The debt forgiveness income resulting from the satisfaction of Claims at a discount should not constitute taxable income. Due to the Debtor's recapitalization under the Plan it is not believed that the Debtors will maintain their existing tax attributes, such as net operating loss ("NOL") carryovers. The utilization of any NOL's remaining after recapitalization and any other application of the attribute reduction rules may be subject to limitations imposed by section 382, among other provisions of the Tax Code. The Debtors do not believe they will maintain any NOL carryovers as of the Effective Date.

*2. Treatment of Debt Discharge Income Under the Plan*

Pursuant to the Plan, the aggregate outstanding indebtedness of the Debtors will be substantially reduced. In general, section 61(a)(12) of the Tax Code provides that a taxpayer who realizes discharge of indebtedness income must include such income ("Debt Discharge Income") in taxable gross income. As a result of the Plan, the Debtors will realize a Debt Discharge if the fair market value of the property transferred by the Debtors to their Creditors for the benefit of its Creditors is less than the amount of Claims that such Creditors have against the Debtors. The Tax Code further provides in section 108(a)(1), however, that if a taxpayer is in a Title 11 case and the discharge of indebtedness is pursuant to a plan approved by a bankruptcy court, such Debt Discharge Income is not required to be included in gross income. However, section 108(b) of the Tax Code further provides that amounts so excluded from gross income will reduce certain tax attributes of the taxpayer, including NOL carryovers and the adjusted tax bases of assets.

Debt Discharge Income could arise with respect to Claim holders if their Claims are discharged by a payment of Cash or distributions of property, including common or preferred stock of the Reorganized Debtors, with a value less than the face amount of the Allowed Claims. The Debt Discharge Income would equal the excess of the debt canceled over the Cash and fair market value of property received in exchange therefore. Regardless of the amount of Debt Discharge Income, for which the Debtors believe will not result under its Plan, there will be no taxable income recognized by the Debtors.

B. Federal Income Tax Consequences to Creditors

*1. In General*

The tax consequences of the implementation of the Plan to a Claim holder will depend in part on (i) whether the Claim holder's Claim constitutes a security for federal income tax purposes, (ii) whether the Claim holder reports income on the accrual basis, (iii) whether the Claim holder receives consideration in more than one tax year of the Claim holder, (iv) whether the Claim holder is a resident of the United States, and (v) whether all the consideration received by the Claim holder is deemed to be received by that Claim holder as part of an integrated transaction. The federal tax consequences upon the receipt of Cash allocable to interest are discussed in "Tax Consequences to Claim holders - Receipt of Interest," below.

A Claim holder will recognize gain or loss on the exchange of his or her existing Claim (other than a Claim for accrued interest) for any consideration. The amount of such gain or loss will equal the difference between (i) the "amount realized" in respect of such Claim and (ii) the adjusted tax basis of the Claim holder in such Claim. Pursuant to section 1001 of the Tax Code, the "amount realized" will be equal to the sum of the Cash plus the fair market value of any other property received in such exchange.

A Claim holder who receives Cash in full satisfaction of his or her Claim will be required to recognize gain or loss on the exchange. The Claim holder will recognize gain or loss equal to the difference between the "amount realized" in respect of such Claim and the adjusted tax basis of the Claim holder in the Claim, and the tax treatment of the exchange will parallel the tax treatment set forth above.

In the case of a Claim holder whose existing Claim does not constitute a capital asset, the gain or loss realized on the exchange will give rise to ordinary income or loss. In the case of a Claim holder whose existing Claim constitutes a capital asset in his hands, the gain or loss required to be recognized will generally be classified as a capital gain or loss, except to the extent of interest. Any capital gain or loss recognized by a Claim holder will be long-term capital gain or loss with respect to those Claims for which the holding period of the Claim holder is more than twelve (12) months, and short-term capital gain or loss with respect to such Claims for which the holding period of the Claim holder is twelve (12) months or less.

*2. Payments Attributable to Interest*

Consideration attributable to accrued but unpaid interest will be treated as ordinary income, regardless of whether the Claim holder's existing Claims are capital assets in his hands and the exchange is pursuant to a tax reorganization. A Claim holder who, under his or her accounting method, was not previously required to include in income accrued but unpaid interest attributable to his existing Claims, and who exchanges his interest Claim for Cash, other property or stock, or a combination thereof, pursuant to the Plan will be treated as receiving ordinary interest income to the extent of any consideration so received allocable to such interest, regardless of whether that Claim holder realizes an overall gain or loss as a result of the exchange of his existing Claims. A Claim holder who previously was required to include in his or her taxable income any accrued but unpaid interest on a Claim may be entitled to recognize a deductible loss, to the extent the amount of interest actually received by the Claim holder is less than the amount of interest taken into income by the Claim holder.

*3. Backup Withholding and Information Reporting*

Under the Tax Code, interest, dividends and other "reportable payments" may, under certain circumstances, be subject to "backup withholding." Withholding generally applies if the holder: (i) fails to furnish his social security number or other taxpayer identification number ("TIN"), (ii) furnishes an incorrect TIN, (iii) fails to report interest or dividends, or (iv) under certain circumstances, fails to provide a certified statement, signed under penalty of perjury, that the TIN provided is his correct number and that he is not subject to backup withholding.

C. Federal Income Tax Consequences to Interest Holders

Pursuant to the Plan, all interests in the Debtors are canceled.

**BECAUSE THE FINAL OUTCOME DEPENDS SO MUCH ON EACH INDIVIDUAL CLAIM HOLDER'S AND INTEREST HOLDER'S SITUATION, IT IS IMPERATIVE THAT EACH CLAIM AND INTEREST HOLDER SEEK INDIVIDUAL TAX COUNSEL FOR ADVICE ON HIS OR HER PARTICULAR SITUATION.**

## XII. MISCELLANEOUS PROVISIONS

As specified in section 1125(e) of the Bankruptcy Code, persons that solicit acceptances or rejections of the Plan and/or that participate in the offer, issuance, sale, or purchase of securities offered or sold under the Plan, in good faith and in compliance with the applicable provisions of the Bankruptcy Code, are not liable, on account of such solicitation or participation, for violation of any applicable law, rule, or regulation governing the solicitation of acceptances or rejections of the Plan or the offer, issuance, sale, or purchase of securities.

## XIII. CONCLUSION

This Disclosure Statement has attempted to provide information regarding the Debtors' estates and the potential benefits that might accrue to holders of Claims against and Interests in the Debtors under the Plan as proposed. The Plan is the result of extensive efforts by the Debtors and their advisors to provide the Debtors' creditors with a meaningful dividend. The Debtors believe that the Plan is feasible and will provide each holder of a Claim against the Debtors with an opportunity to receive greater benefits than those that would be received by any other alternative available to the Debtors. Therefore, the Debtors urge you to vote in favor of the Plan.

Through confirmation of the Plan, the Debtors believe that they can resolve all Claims that have been, or could be, asserted against them in a timely and cost-effective manner. The Debtors believe that the Plan provides a mechanism to resolve and provide just compensation to all Claim holders. The Debtors believe that the Plan is fair to all parties-in-interest and should be approved by all persons entitled to vote.

Whether or not you expect to attend the Confirmation Hearing, which is scheduled for _____________ a.m. Central Time, you must sign, date, and mail, hand deliver, or fax your Ballot as soon as possible for the purpose of having your vote count at such hearing. All votes must be received by the Debtors' counsel, as indicated on the Ballot, on or before **5:00 pm. Central Time on __________.** Any Ballot that is unsigned, illegible, or that fails to properly designate an acceptance or rejection of the Plan with an appropriate Claim amount may not be counted as a vote in favor of the Plan.

**DATED:** October 28, 2011
Fort Worth, Texas.

**REOSTAR ENERGY CORPORATION, ET AL**

**By: __*/s/ M.O. Rife, III*______________________**

**Its:__CEO___________________________**

**AND**

**RUSSCO ENERGY LLC**

**By: __*/s/ R. Kevin Russell*_________________**

**Its:__authorized representative____**

**Respectfully submitted by:**

**Bruce W. Akerly**
**Texas Bar No. 00953200**
**bakerly@canteyhanger.com**
**Arthur A. Stewart**
**Texas Bar No. 19203500**
**astewart@canteyhanger.com**
**CANTEY HANGER LLP**
**1999 Bryan Street, Suite 3330**
**Dallas, Texas 75201**
**Telephone: (214) 978-4129**
**Facsimile: (214) 978-4150**

**COUNSEL FOR**
**DEBTORS-IN-POSSESSION**

**Stephanie D. Curtis**
**Texas Bar No. 05286800**
**scurtis@curtislaw.net**
**Mark A. Castillo**
**Texas Bar No. 24027795**
**mcastillo@curtislaw.net**
**CURTIS | CASTILLO PC**
**901 Main Street, Suite 6515**
**Dallas, Texas 75202**
**Telephone: 214.752.2222**
**Facsimile: 214.752.0709**

**COUNSEL FOR CO-PROPONENT**
**RUSSCO ENERGY LLC**

# EXHIBITS TO DISCLOSURE STATEMENT

| | |
|---|---|
| **EXHIBIT "A"** | **Debtors' Second Amended Joint Plan of Reorganization, dated October 28, 2011** |
| **(Annex "1" to Exhibit "A")** | **Glossary of Defined Terms** |
| **EXHIBIT "B"** | **Debtors' Projected Monthly Financial Data after Confirmation, Including Required Plan Payments** |
| **EXHIBIT "C"** | **Debtors' Chapter 7 Liquidation Analysis v. Debtors' Proposed Chapter 11 Reorganization** |
| **EXHIBIT "D"** | **Ownership Structure of MK Oil and BTMK** |
| **EXHIBIT "E"** | **Structure of Michael Kenwood Entities** |
| **EXHIBIT "F"** | **Russco Energy LLC Term Sheet** |
| **EXHIBIT "G"** | **Proof of Financial Ability to Fund purchase of new interest on behalf of Russco Energy LLC** |
| **EXHIBIT "H"** | **Proof of Financial Ability to Fund purchase of new interest on behalf of Rife/Bennett Group** |